

No. 12506

United States
Court of Appeals
for the Ninth Circuit.

See vol 2630

WESTERN PACIFIC RAILROAD CORPORATION and ALEXIS I.
duP. BAYARD, Receiver,

Appellants,

vs.

WESTERN PACIFIC RAILROAD COMPANY, SACRAMENTO
NORTHERN RAILWAY, TIDEWATER SOUTHERN RAILWAY,
DEEP CREEK RAIROAD COMPANY, THE WESTERN REALTY
COMPANY, THE STANDARD REALTY AND DEVELOPMENT
COMPANY and DELTA FINANCE CO., LTD.,

Appellees.

MEREDITH H. METZGER, HENRY OFFERMAN and J. S. FARLEE
& CO., INC.,

Appellants,

vs.

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NORTHERN RAILWAY, TIDEWATER SOUTHERN RAILWAY,
DEEP CREEK RAILROAD COMPANY, THE WESTERN
REALTY COMPANY, THE STANDARD REALTY AND DE-
VELOPMENT COMPANY and DELTA FINANCE CO., LTD.,

Appellees.

Transcript of Record
In Five Volumes

Volume IV
(Pages 1363 to 1796)

Appeals from the United States District Court,
Northern District of California,
Southern Division.

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PAUL GRADY

called on behalf of the defendants; sworn.

The Clerk: State your name to the Court, please.

The witness: My name is Paul Grady, G-r-a-d-y.

Direct Examination

By Mr. Adams:

Q. Where do you reside, Mr. Grady?

A. I reside in Greenwich, Connecticut.

Q. And you have your office in New York?

A. That is correct.

Q. What is your profession?

A. I am a certified public accountant.

Q. Are you now associated with Price, Waterhouse & Company? A. I am.

Q. In what capacity?

A. I am a partner of the firm.

Q. In how many States, Mr. Grady, do you hold a certificate as a certified public accountant?

A. Eleven States, including the State of California. [1233]

Q. Did you study accountancy in college?

A. I did.

Q. And where?

A. At the University of Illinois.

Q. When did you graduate?

A. I graduated in 1923.

Q. With what degree?

A. With a degree of Bachelor of Science.

Q. What was your first association as an accountant?

(Testimony of Paul Grady.)

A. Almost immediately after graduation from the University of Illinois I became a member of the staff of Arthur Anderson & Company in Chicago.

Q. How long did you remain with Arthur Anderson & Company?

A. Approximately nineteen years.

Q. And at that time, a part of that time, you were a partner in that firm?

A. I was a partner the last ten years of my association with the firm.

Q. While you were with Arthur Anderson & Company did you specialize in any particular field of accounting work?

A. I specialized in public utility accounting, although that was not exclusively my type of work.

Q. And were you in charge of the public utility work for Arthur Anderson & Company?

A. I was in charge of the public utility work in the New York [1234] office of Arthur Anderson & Company for a period of five years. Subsequently I was in charge of the public utility work for the entire firm for a period of approximately three years.

Q. When did you leave Arthur Anderson & Company? A. The early part of 1942.

Q. And what was your next association?

A. I left Arthur Anderson & Company to go with the United States Navy Department at the request of Secretary Forrestal, for the purpose of assisting in the organization and determination of

(Testimony of Paul Grady.)

the policies of the cost inspection service of the Navy Department, that being the auditing organization of the Navy that was set up during the wartime period to audit procurement contracts.

Q. And would you describe briefly the work you did for the Navy.

A: Well, during that period my technical position was executive assistant in the Secretary's office, and I was assigned to the Cost Inspection Service in the Bureau of Supplies and Accounts. I assisted in setting up the policies in the preparation of the audit manual covering the procedures by which contracts were to be audited, and assisted in setting up the form of organization and in obtaining competent accounting personnel to fill the key spots in the organization. The organization had approximately 6000 employees after it was fully in operation.

Q. When, Mr. Grady, did you become associated with Price, [1235] Waterhouse & Company?

A. I became associated with Price, Waterhouse & Company in May of 1943, after the completion of my full-time assignment with the Navy Department.

Q. Now, would you describe, please, in general the fields in which you worked as an accountant.

A. During the period of something over a quarter of a century I have had experience in public utilities, railroads, manufacturing, general merchandise and financial type of business enterprises. I have also had considerable experience with Government corporation type of activities, as represented

(Testimony of Paul Grady.)

by the Reconstruction Finance Corporation, Federal Deposit Insurance, Rubber Reserve and Rubber Development, to name some of them. [1236]

Q. In respect of those governmental agencies, you have been engaged in work for the government of an accounting nature?

A. That is correct, accounting and auditing.

Q. Have you recently been connected with the commission on the organization of the executive branch of the United States Government?

A. I have.

Q. That is the commission sometimes known as the Hoover Commission? A. That is correct.

Q. What work have you done for that commission?

A. I was given the responsibility for making the survey of the lending agencies of the government for the purpose of preparing factual reports as well as a report on recommendations to the commission for the commission's consideration in arriving at their own recommendations to Congress.

Q. Have you recently made studies for the national military establishment?

A. I have been a member of a committee of five which has undertaken a rather comprehensive survey of the accounting—and by that I mean not only accounting in the sense of records but also in the broader sense of accounting control and budgetary procedures—of the national military establishment for the purpose of arriving at specific

(Testimony of Paul Grady.)

recommendations for the Secretary of Defense, and I might add that our report was likewise used [1237] by the task force covering the area of the Department of Defense for the Hoover Commission.

Q. Of what professional societies are you a member?

A. I am a member of the New York State Society of Certified Public Accountants; the Illinois Society of Certified Public Accountants; and the American Institute of Accountants. The latter is the national professional organization of certified public accountants.

Q. Have you been a member of some of the committees of the American Institute of Accountants?

A. Yes, I have been a member of quite a few of the committees.

Q. And you have been a chairman of some of those committees? A. Yes, sir.

Q. Would you name some of the committees of which you have been chairman?

A. I was chairman of the American Institute committee on Public Utilities, in 1939 and 1940. I was also chairman of the committee on Auditing Procedure, which is one of the two principal technical committees of the Institute, during the four years that just ended last fall.

Q. You have done some writing on accounting questions?

A. Yes, I have written a fairly numerous amount of articles.

(Testimony of Paul Grady.)

Q. Could you give me a brief description of the nature of your publications?

A. Most of them deal with—— [1238]

The Court: Mr. Adams, is this witness going to testify to the same subject matter that the accountant testified for the plaintiff?

Mr. Adams: No, your Honor.

The Witness: Most of them deal with accounting, auditing and financial subjects, and they have been published for the most part in professional type of publications—I mean of the American Institute of Accounting or the American Accounting Association, which is the national organization of accounting instructors.

Q. Have you had any accounting experience with the railroad industry?

A. Yes, I have had accounting experience with the railroad industry.

Q. When did that begin?

A. Well, it began in the early 1920's, in the early days of my auditing experience. The principal amount of it during that period related to interurban electric railways, which at that time were quite commonly owned in affiliation with public utility groups. I have likewise had some experience in steam railroads. Would you like me to describe it or is that a part of the question?

Q. Would you please give a general description of your accounting experience in the railroad industry, adding anything you had in mind to supplement what you have already said.

(Testimony of Paul Grady.)

A. I have made the purchase investigations of the Alton Eastern [1239] Railway, the Litchfield and Madison, Illinois Terminal. I have supervised special studies of the accounts of the Illinois Central Railroad. I have recently been engaged in the rate case proceedings for the Canadian Pacific Railroad in Canada. I have likewise been consulted from time to time in connection with accounting and auditing matters for railroad clients handled by my firm, which includes the New York Central Railroad, Missouri Pacific, Frisco, Kansas City and Southern, Chicago, Rock Island and Pacific.

Q. Mr. Grady, in your accounting work have you had occasion to consider accounting problems of affiliated companies? A. Yes, sir.

Q. Would you say that your work in that connection has been a substantial part of your accounting experience?

A. Yes, it has been a substantial part.

Q. Could you give me roughly an estimate of what part of your work has been with the problems of affiliated companies?

A. I should judge that most of my accounting and auditing experience has been related to groups of more than one company, that is, a group containing more than one company in the corporate structure, to the extent of perhaps more than 50 per cent of my total time.

Q. When did your work involving affiliated groups begin?

(Testimony of Paul Grady.)

A. That began in the very early days of my experience.

Q. Has it continued up to the present time.

A. Yes, sir.

Q. In connection with your work on groups of affiliated corporations, have you had occasion to consider the tax problem of these groups?

A. From an auditing and accounting viewpoint, Mr. Adams, yes.

Q. In that connection have you had occasion to consider the allocation of taxes among group numbers under consolidated returns?

A. Yes, that is one of the problems with which I would deal.

Q. How does that matter come to your attention in your work?

A. In the examination of the tax accounts—by that I mean the tax accrual accounts, which are the liability accounts, and the tax provisions, which are expense accounts—it is necessary in the examination of any group of companies for the independent accountant to determine three things:

First, that the liabilities for federal income taxes for all years which may be open are reasonably provided for;

Second, that the tax provisions for the particular year for which income statements are being given are reasonable provisions in relation to the taxes owed to the government on account of the operations for those years;

(Testimony of Paul Grady.)

And thirdly, that the allocations within the group, between affiliated companies, are on some reasonable basis. The latter point is, of course, particularly important where the accountant is asked to give his opinion with respect to the financial [1241] statements of individual companies.

Q. Are you familiar, Mr. Grady, with the customary business practice for allocating taxes under consolidated returns?

Mr. Phleger: May it please the Court, I am going to object at this time as it is perfectly evident what the course of subsequent questions will be. I object to this whole line of testimony. I take it that what counsel is trying to do now is to prove, if there be such, some general practice of allocating the taxes between companies joining in a consolidated return, and I submit that the testimony is irrelevant, incompetent and immaterial. I have previously urged that the practice of those companies themselves is not admissible. How any general custom, if there be such, would be admissible is wholly beyond me. It is not even shown that the custom was known to the parties. We have a situation here which counsel on the other side has said is unique, and it seems to me that this testimony therefore is utterly irrelevant, incompetent and immaterial. If the witness proposes to testify as to what the law is, then it is also not admissible.

Mr. Adams: Are you finished?

Mr. Phleger: Yes.

(Testimony of Paul Grady.)

Mr. Adams: First, responding to the last statement that Mr. Phleger made, we do not have any purpose, your Honor, to ask the witness to testify with regard to the law, of course. The law is for your Honor to determine, and no testimony from this witness is adducible on the subject of what the law is. Our purpose in producing this witness to give testimony with regard to the business practice, is that only, and I think counsel has fairly stated that he anticipates that is our purpose, and it is our purpose. We propose to draw to your Honor's attention, as a material factor, a business factor as a fact that your Honor may consider. We expect to show that under the established business practice for the allocation of taxes, the taxes are allocated among the members of the group without making any payment such as the plaintiff demands here. And in my opening statement to the court, I said we expected to adduce proof of the practice of business as one of the elements in our defense. Of course we are not bound by plaintiff's theory—your Honor has referred to that. We expect to show that the only recognition given in business practice, at the most, is recognition to a particular company that joins in a consolidated return, which will put it in a position not less favorable than it would have been on a separate return basis. In this case the corporation would have been in no different position, the plaintiff, on a separate return basis.

(Testimony of Paul Grady.)

Now we have called Mr. Grady to produce testimony with regard to business practice and not with regard to any question of law. That is clearly so. Now your Honor, we think this evidence does bear directly on the fundamental issue, whether the plaintiff has a claim. The claim, it is admitted, is [1243] predicated upon a position it was of no consequence whatever to the plaintiff corporation, whether or not a separate or a consolidated return was filed.

And so in bringing to your Honor's attention a business practice, just as long ago business practices were brought before Lord Mansfield, we believe we are bringing to your Honor's attention a matter of significance and materiality that your Honor would wish to consider in determining the issues that this particular case presents for your Honor's determination. And it will be our position that in many a consolidated return situation, there are the possibility of claims such as are here presented, but the fact is otherwise. So that in any defense of the matter before your Honor, though this is defined by plaintiff in his definition as a special consideration, will require necessarily consideration of the effect such a decision might have upon an established business practice of not paying loss companies for tax advantage of their losses.

May I say further, in our own theory of the case, the ultimate question before your Honor is whether or not a loss company is entitled to be paid for the tax advantage its loss brings to the group. We do

(Testimony of Paul Grady.)

not agree with plaintiff's view that the plaintiff's own case presents such a special situation, that a special rule can be made for it, different from the rule generally obtaining in business practice.

Then, your Honor, we think this evidence is also material [1244] in refuting the interveners' position; counsel for the interveners, my friend, Mr. Levy, the other day made a somewhat elaborate and to me, quite clear, statement of his position. If I may take the privilege of paraphrasing it briefly, as I understand it, it was that in view of the relation between the members of the affiliated group, the tax transactions had to be conducted fairly, and there was a suggestion made that fairness required that payment be made to the loss company. Now we think the best evidence of fairness, or at least material evidence of fairness, may be found in the fact we seek to prove, that American business has never found occasion to make payment for the use of losses included in consolidated returns. We will argue that this equity court will not impose a rule contrary to the standards of the business community which, in our judgment, is in fact predicated upon the notion that the plaintiff corporation had a position to exact or coerce a payment, though its own joiner in the return was wholly immaterial to itself. [1245]

And then, if your Honor please, there is one other fact that this matter of business practice is material to: Both of our adversaries have gone to

(Testimony of Paul Grady.)

great pains to point out that the persons who handled the transactions had positions both with the plaintiff corporation and with the court's trustees. And it is contended that by reason of this, your Honor is entitled to review what was done at that time. Now, it is well established that in any case of a review of that sort, assuming that in this case this is an appropriate case for a review of that sort, the review cannot be made on the basis of hindsight. It must be based upon a perception of the conditions as of the time the transactions took place. And it will be our position that the officers and directors of the corporation at that time were fully justified in handling this transaction, if they followed what we seek to prove, namely, the established procedures customarily used in the business field.

I have stated at some length the reasons why we seek to introduce into the record of this case and to bring before your Honor not a question of law, but a question of fact, as of course the matter of business practice is. And those are my purposes in producing Mr. Grady and conducting this examination.

I might say further, just directing your Honor's attention to an allegation in the complaint in intervention, page 20 at the bottom, referring to the tax transactions here in [1246] issue, "Said transactions were in violation of recognized and good accounting practice." Now, that is another issue.

(Testimony of Paul Grady.)

It is not an issue directly responsive to the question of—well, I think it is. So far as it says that they are in violation of recognized and good accounting practice, I would submit, your Honor, that proof of what the practice of independent industry was with regard to this matter would be responsive to this allegation. That is an additional ground to those I have heretofore stated, on the basis of which we submit, your Honor, that the evidence sought to be adduced with regard to the business practice in this very matter is material and relevant to the issues in this case.

* * *

Mr. Adams: May I just add one minor remark? Counsel in stating an objection referred to the fact that the practice or custom that I seek to adduce at this time has not been shown to be known to the parties. I do not think that is material, but if it is material, we have evidence by which we can connect it up.

Mr. Levy: Your Honor, there is just a question or two to Mr. Adams, to clarify my own understanding of what the function of this witness is. Is the witness produced to [1247] testify as to business practice, accounting practice, or both?

Mr. Adams: The witness is produced to testify to the practice, custom and usage of business. I am not at all clear whether I shall ask him any questions about accounting practice, but he is of course experienced in that, and I would not have the slight-

(Testimony of Paul Grady.)

est objection to his being asked by any counsel on accounting practice, regardless of whether or not I opened that subject with him. [1248]

* * *

The Court: I am not discussing this matter with you on the theory that I think the plaintiff is entitled to recover in the case. I just don't see the point of what any affiliated company has done in the past as a matter of practice in these returns, because they have all been decisions that have been made by the parent company, and when the parent company decided that it was proper to file affiliated returns, it filed them, and of course there is no dispute about the fact that the parent company filed the affiliated returns whenever it decided it was [1253] proper to do so. What we have in this case is not concerned with that. It is a question whether under these circumstances, according to what I have heard so far, the parent company did decide to file this affiliated return in this case under the circumstances, whether it was the decision and action, in fact, under the particular circumstances that we have here of the parent company, No. 1; if it was not, then was there any liability or right that accrued to the parent company by virtue of what was done? I do not see that what this witness can say as to the practice of allocating taxes in this kind of return would have any particular bearing upon the matter. I think I could answer the question for him. And I do not see that it

(Testimony of Paul Grady.)

would add anything to it. I would think that probably you could not put your finger on a case in the United States where there was an affiliated return filed where anybody ever allocated any taxes between the companies. Why should they? There would not be any purpose to it.

Mr. Adams: Your Honor, I think from that standpoint the investigation we have made and the experience of Mr. Grady would aid your Honor because there is a standard practice of allocating taxes, and there was twenty years ago an investigation by the Federal Trade Commission that we ourselves as counsel expect to draw to your Honor's attention under which the Federal Trade Commission investigated the practices of holding companies with respect to intercompany transactions in Federal income tax [1254] and certain practices of the holding companies, literally the practice of lifting up computed taxes from subsidiaries, were found to be wrong, and the holding company act was passed, and now we have certain legal limitations and rules of the Securities and Exchange Commission with regard to that. But those are matters which are mentioned in response to your Honor's thought that the holding companies managed all of this as if it were their own. Of course, as long as there is no other interest—if there is a hundred per cent ownership, and no equity ownership in the subsidiary, the problem does not arise any way because it makes no difference what the parent com-

(Testimony of Paul Grady.)

pany does with its own. But the problem immediately arises where in the chain of corporations there are minority interests, as very frequently there are; then the question of right comes up and your Honor has before him in this case a question of right. It is not a question of what a parent company has power to do. I am sure your Honor is never going to grant a judgment on the basis that the parent corporation had the power to hold up the court.

The Court: I am inclined to agree with you on that, but what flowed from what was done in this case? What right flowed from what happened in this case, if any?

Mr. Adams: Your Honor is going to look to see if this plaintiff corporation has a right. We think it would assist your Honor's consideration of that matter to have before your [1255] Honor certain facts, and we do think—this is our own view of the matter and our own case that we are seeking to put in—that the general business practice is a material fact, for the reason that, as we see it, if there is a general business practice that is followed, then immediately the burden is upon the other side to show why under the particular circumstances a departure should be made from the general business practice. I have said this before, and I do not want to tax your Honor's patience too much, but we do regard this as a part of our case.

The Court: The question would never arise under the general business practice, because I do

(Testimony of Paul Grady.)

not think you would ever have any litigation. Absent the kind of situation that you have here between companies that were free agents to agree with one another to file this type of return. Here you have a situation where a third party, a new party, is getting the benefit of this tax situation. Now, maybe it is right it should. I am not attempting to decide that question. I can see that that is a difficult one upon which you gentlemen have given me much to think about. But the problem that is presented by it is entirely different from what might happen in the ordinary business relationship of parent and subsidiary companies, where you have not the interposition of reorganization proceedings and all that they entail. [1256]

* * *

The Court: I think there is not a fair comparison there [1263] with admiralty because it is pretty much of a different type of jurisdiction. But frankly, Mr. Adams, I cannot see that business practices are competent by way of evidence in the case unless it is necessary to make use of them in order to properly interpret a contract, something that the parties have agreed to that presents a problem which needs explanation because of uncertainty or ambiguity as to the meaning of what the parties have agreed to do. Resort can always be had, then, under the old-time rule of Lord Coke (somebody else cited some other lawyer, so I will cite one, too): "You show me what the parties

(Testimony of Paul Grady.)

have done under the contract, and I will tell you what they meant by their contract."

You can, evidentially speaking, of course, produce this type of evidence in situations of that kind, but all that kind of evidence, it seems to me, would do in a case like this might be to lead the court into error, just as much to your disadvantage as it might be to your advantage if you win the case, because a reviewing court might well say the judge was influenced by what other people did at other times where the disputes were not judicially determined. They may say he should not have done that. He was listening to rumor; he was listening to what they did in the stock exchange, what the railroad companies did between one another as a matter of practice. That had an effect on his mind which it should not have had. He should have only listened to the relevant evidence in [1264] the case. I think you may call my attention by way of argument, with wide latitude, to any precedents of any kind, experiences, in an argumentative way, in support of the reason and justice of your side of the case, but I think that this type of evidence would produce error if the Court were to admit it. I think there was only one question before the Court at the time, but I think the colloquy has established fully the nature of the testimony that the witness is to give, and I think the proper holding would be to say that that is immaterial and incompetent and should be excluded.

(Testimony of Paul Grady.)

Mr. Adams: I would like in that connection, your Honor, at this time to make an offer of proof so that we can have a clear record of what it is that we are offering, and possibly your Honor may think, as I go through this, that the ruling that your Honor has made is not covered. I would also like, before I make my offer of proof, to direct the Court's attention to the fact that this objection came upon the following question:

"Are you familiar with the customary business practice for allocating taxes owing under consolidated returns?"

I think I am entitled to an answer to that question. The objection then would be to the question, "What is the practice?"

The Court: Of course, you agreed with Mr. Phleger as the argument proceeded, and I took it for granted we were not [1265] proceeding on too technical a basis. You agreed with Mr. Phleger as to the nature of the evidence that the witness was going to testify to.

Mr. Adams: There is no doubt about that. My point is this: In order to qualify my witness I think I should have an answer to this question. It does not produce any testimony as to what the practice is.

The Court: All right. You may answer it.

Q. (By Mr. Adams): Mr. Grady, are you familiar with the customary business practice for allocating taxes owing under consolidated returns?

(Testimony of Paul Grady.)

Mr. Phleger: This assumes that there is a custom. [1266]

The Court: Well, if there be such customs, are you familiar with them?

The Witness: Yes, sir.

The Court: All right.

Mr. Adams: Of course there is no doubt there is a customary business practice, and I am surprised that counsel makes such a suggestion. Then my next question is, after this one: What is that practice. And I understand counsel states an objection to that.

Mr. Phleger: Right:

Mr. Adams: And the Court ruled that the objection is sustained?

The Court: Right.

Mr. Adams: Now then, your Honor, I should like to ask Mr. Grady three or four more preliminary questions, which will develop the fact that in addition to speaking from his own experience, he has made a special study. And I think I am entitled to develop that fact. And then an objection may be made.

The Court: Well, is there any further objection, or any objection to the further qualification of the witness?

Mr. Phleger: No, but I would point out that if this is a general custom known to everyone, why does he have to make a special study?

Mr. Adams: I see no reason for these interpolated arguments.

(Testimony of Paul Grady.)

Mr. Phleger: Well, that was indirect response to the Court. [1267]

Mr. Adams: I am frequently advised by Mr. Phleger in advance of hearing the question what his point is about something he anticipates I am going to say.

The question is, your Honor, those are the questions: In connection with this litigation, were you asked to make an investigation to supplement your own information as to the general practice of allocating taxes under consolidated returns.

The Court: Well, Mr. Adams, do you feel that this long colloquy and argument we have had doesn't sufficiently describe the nature of the testimony of the witness?

Mr. Adams: No, your Honor, not at all.

The Court: And what you would have to show is such that you would have to make a further elaborate statement?

Mr. Adams: No, that is not my purpose at all; I have to put on my proof for the record, and this is simply a preliminary matter of proof, that a study was made. I am sure I am entitled to do that. And then there may be objections, your Honor. I have got to establish first that a study has been made. Now nothing objectionable results from that. But if I am not able to show that, I haven't shown what my witness would say, the entire basis of his qualifications to answer these questions, and of his investigation. I am not going to

(Testimony of Paul Grady.)

ask any questions as to what the practice was.

The Court: Well, there is a popular misconception amongst lawyers on this idea of making an offer of proof. It doesn't [1268] add anything to the record in the case. The only purpose of an offer of proof—or at least when I used to make them myself—was to get the judge to know about the thing that I wanted to get in anyhow, thinking that might make some difference. But if the question is objectionable and there is a good objection to it, there is no need for making an offer of proof. In any case, there is certainly no misunderstanding as to any of the lawyers here as to what we are talking about.

Mr. MacKinnon: Well, under the federal rules, there is a definite procedure to be followed now, and I think it is rule 43.

The Court: Well, what is that?

Mr. Adams: But your Honor, I am not even seeking to make an offer of proof, I want to ask some preliminary questions of the witness, just as I did before.

The Court: Very well.

Q. (By Mr. Adams): In connection with this litigation, were you asked to make an investigation to supplement your own information as to the general practice of allocating taxes and under consolidated returns? A. Yes.

Q. Was it left to you to determine in what field the investigation should be made? A. Yes.

(Testimony of Paul Grady.)

Q. What fields did you select? [1269]

A. I selected the public utility field, the steam railroad field and the general field of industrial practice.

Q. And why did you select these fields?

A. Because I thought they perhaps constituted the major segments of industry in which large scale or more than, multiple, corporate enterprises existed.

Q. And when did you begin this investigation?

A. In June of 1948.

Q. And when was the investigation completed?

A. Approximately February 1, 1949.

Q. Did you have some assistance in conducting it?

A. Yes, I had numerous assistants from my own organization.

Q. And was it conducted under your supervision and direction? A. Yes, sir.

Q. Will you describe the investigation you made in the public utility field, without stating anything about the results? A. We examined—

Mr. Phleger: Well, if your Honor please, it is perfectly obvious that this witness made a very extensive examination, and I don't think—

Mr. Adams: Well, why not hear about the results?

Mr. Phleger: Why hear about it?

The Court: Well, the witness has answered, and the record may show that he made an extensive and

(Testimony of Paul Grady.)

thorough examination of the organization, with the organization he had at his command, [1270] and the assistants and so forth concerning this matter you want to interrogate him about. So you needn't go into detail on that, I don't think. [1271]

* * *

The Court: If you think it is necessary after all this discussion, after all the discussion we have had during the last half hour, all that was elicited—if you think that nevertheless you have to particularize on the very matter we have agreed to, as the subject matter of the testimony, why, I cannot agree with you on it but if you want to make an offer of proof and take up that time in doing it, why I will allow you to do so.

Mr. Adams: Your Honor, I do feel that it is incumbent upon me in the pursuance of my responsibilities to make an offer of [1272] proof, and not for the purpose of rearguing any matter, but so that I may have my record. And it is for that purpose that I now make this offer of proof, to prove:

"That the witness, Paul Grady, reviewed or directed the review of reports filed with the Securities and Exchange Commission for the years 1942 to 1947, inclusive, of the 52 registered public utility holding company systems which are listed in the June 30, 1947, report of the Public Utilities Division of the Securities and Exchange Commission; that 52 holding company systems included 824 individual companies, the total consolidated assets of

(Testimony of Paul Grady.)

which amounted to approximately \$15,350,000,000; that the review was carried out to determine, wherever possible, whether consolidated or separate Federal income tax returns were filed and, in the case of the companies filing consolidated returns, to ascertain any information shown regarding the income tax reductions resulting from consolidated returns and the method of allocation among affiliated companies of such reductions; that in the case of 20 of the systems it could not be determined what types of income tax returns were filed; that 3 of the systems filed separate returns; that 29 filed consolidated returns.” [1273]

* * *

Mr. Adams: If your Honor please, with the consent of all counsel, the offer of proof which I started to read may be copied into the transcript without the necessity of reading it before your Honor.

The Court: Very well.

“That there were only five exceptions to Rule U-45 by the 29 systems which filed consolidated returns during the six year period; that two of these exceptions were granted to Consolidated Electric and Gas Company (a Subholding company of Central Public Utility Corporation), and one each to Cities Service Company, Ogden Corporation and United Public Utilities Corporation; that in four of these cases, the exceptions from the rule were requested and granted in order that particular subsidiary companies would not be in a less favorable

(Testimony of Paul Grady.)

position than they would have been had they not been a party to a consolidated income tax return; that in the case of one of the exceptions granted to Consolidated [1274] Electric and Gas Company, the holding company was permitted to distribute the consolidated tax in such a manner as to collect from the subsidiary companies the amount of tax reductions attributable to specific investment losses incurred by the parent in the disposition of securities of former subsidiaries; that the Securities and Exchange Commission justified this exception, in part, on the grounds that 100% of the common stocks of the subsidiaries was owned by the parent company and therefore the parent would be in no different position than if the amounts had been paid as extra dividends; that the exceptions are fully described in Securities and Exchange Commission releases Nos. 4444, 4806, 5535, 5904 and 6375; that the review identified income tax reductions resulting from the filing of consolidated returns by registered public utility holding companies in an amount not less than \$72,000,000.00; and that many of these deductions totaling many millions of dollars were attributable to unusual and extraordinary types of tax deductions.

Class I Railroads

Defendants offer to prove:

That the witness, Paul Grady, reviewed or directed the review of stockholders' reports and the

(Testimony of Paul Grady.)

annual reports filed with the Interstate Commerce Commission for the [1275] years 1942 to 1947, inclusive, of all Class I railroads having more than four thousand miles of track for the purpose of ascertaining any information shown relating to the practices followed in allocating consolidated Federal income tax among members of an affiliated group; that inasmuch as these reports did not show any information on the subject, the witness interviewed or directed the interview of officials of 22 Class I railroads for the purpose of ascertaining the practice followed in the allocation of income taxes among affiliated companies during the periods for which consolidated income tax returns were filed; that the total revenues in 1946 of the aforesaid 22 railroads were two-thirds of the total revenues of all Class I steam railroads for that year; that in the cases of 20 of the 22 railroad systems, tax reductions from consolidated returns were allocated pro rata to companies having taxable net income; that two of the systems allocated such tax reductions to the parent company up to the point of offsetting the parent company's tax and any further tax reductions were allocated pro rata to subsidiary companies having taxable net income; that none of the 22 Class I railroad companies followed a practice of making payments to companies having taxable net losses, except in recognition of "carry-back" or "carry-forward" circumstances and [1276] then only to the extent necessary to put the particular

(Testimony of Paul Grady.)

company in a position not less favorable than it would have occupied on a separate return basis.

General Industrial and Commercial Companies

Defendants offer to prove:

That the witness, Paul Grady, in order to ascertain, where possible, the practice of allocating taxes followed by industrial companies, made or directed a review of the Forms 10-K and stockholders' reports filed with the New York Stock Exchange during the years 1942 to 1947, inclusive, by the companies included in the Dow-Jones list of industrials; that the reports of these thirty companies did not disclose any information relating to consolidated income tax allocation; that Price, Waterhouse & Co. audits one-third of the companies included in the list; that none of these companies follows the practice of making payments to companies having taxable net losses, except in recognition of "carry-back" or "carry-forward" provisions in order that the companies would not be in a less favorable position as a result of participation in consolidated returns; that the witness requested the Price, Waterhouse offices in the United States to report to him cases in which any of their client companies filing consolidated tax returns had allocated income tax reductions on bases other than [1277] pro rata (in relation to net taxable income or to separately computed taxes) to companies having taxable net income; that four cases were reported to him in

(Testimony of Paul Grady.)

which taxable net incomes amounts equal to taxes computed on an individual return basis; that in effect the parent companies thus retained the entire tax reductions arising from consolidated returns; that in three of the four cases 100% of the securities, both debt and stock, of the subsidiaries were owned by the parent; that in all of these cases, the amounts collected from subsidiaries did not exceed the consolidated income taxes and no payments were made to companies having taxable net losses except in recognition of "carry-back" and "carry-forward" circumstances.

General

And finally that the studies and inquiries made of public utility holding company systems, general industrial companies and Class I railroads demonstrate the practice followed by business enterprises in the allocation among affiliated companies of the income tax reductions arising from the filing of consolidated returns; that the customary practice in all three fields is to allocate the consolidated tax reductions pro rata among the companies having taxable net incomes; that such pro rata allocations have been accomplished by two principal methods: first, in relation to the taxable net incomes of those companies having such net incomes and, second, in relation to the computed taxes of each company if paid on a separate return basis; that in carrying out the second method it is sometimes necessary to make

(Testimony of Paul Grady.)

payments to companies in recognition of the effect of "carry-back" and "carry-forward" provisions of the income tax laws and regulations; that the reviews and inquiries disclosed a few exceptions to the foregoing general practice of pro rata allocation of income tax reductions arising from consolidated returns; that such exceptions may be grouped into two general categories; first, because of exceptional circumstances payments have been made to certain companies in order that they will not be adversely affected due to participation in consolidated income tax returns and, second, parent companies have in a few cases taken more than their pro rata share of the consolidated tax reductions; that in most of the latter type of cases the parent companies owned all of the senior securities of the subsidiaries as well as 100% of the voting stock; that the reviews and inquiries did not disclose any case in which payments had been made to a member of an affiliated group merely because such member had produced a taxable loss, thereby reducing the consolidated income tax which otherwise would have been payable." [1279]

Mr. Adams: No further questions of Mr. Grady. He is here for cross-examination if counsel desire to examine him.

The Court: Is there anything in this offer of proof that goes beyond the general compass of the subject matter that we have discussed, that you feel you should have before the Court, or is it the detail

(Testimony of Paul Grady.)

of the investigation and statement of the witness concerning the practices he finds to have existed as a result of his investigation?

Mr. Adams: I think that is a fair characterization of it, your Honor; it is wholly related to the matter of business practice, the studies made, and the practice as found, and the details.

Mr. Phleger: Now I don't know whether, the offering having been demed to be made, it is necessary for me to interpose an objection. If it is, I do, upon the grounds previously stated, and upon the further ground that an investigation of the offer indicates that it is not expert testimony about a custom, but the result of an inquiry and investigation summarized.

Mr. Clark: We join in that objection, your Honor.

The Court: Well, we may consider then that the offer of proof was made as a part of the proceedings upon the objection as made by your opponent, Mr. Adams, and that the ruling made is that the offer of proof, the proof offered, is held to be inadmissible as being incompetent, irrelevant and immaterial.

Mr. Adams: Yes, your Honor. [1280]

The Court: So your record will thus be clear.

Mr. Adams: Yes, your Honor, and I think counsel's later statement is correct. But so that I may have my record, I also offer at this time to prove upon the basis of the testimony of the wit-

(Testimony of Paul Grady.)

ness as to his own qualifications, that the witness is prepared to state what the practice is. And in that connection, he is prepared to state with regard to the practice, that with very minor exceptions within his personal knowledge, the practice was the practice of allocating taxes and that only among members of the group, and of not paying anything to a loss company for the tax advantage this loss brings to the consolidated group. I offer that in addition to the offer made on the basis of the studies.

Mr. Phleger: Well, this is an additional offer now?

Mr. Adams: That is right, upon the basis—

Mr. Phleger: Well, I make the same objection.

The Court: Same ruling in that regard. [1281]

* * *

Mr. Phleger: We have no cross-examination.

The Court: In other words, it would not be necessary for this witness to return for the purpose of being cross-examined on the subject matter of the offer of proof.

Mr. Phleger: No.

Mr. Clark: I think not, your Honor.

The Court: Very well.

(Witness excused.) [1282]

* * *

Mr. Adams: May I call Mr. Polk?

JAMES K. POLK

called as a witness on behalf of the defendant, sworn.

The Clerk: Will you state your name to the Court, please? A. James K. Polk.

Direct Examination

By Mr. Adams:

Q. Mr. Polk, will you please state your business and business address?

A. I am an attorney at law, member of the firm of Whitman, Ransom, Coulson and Goetz, with offices at 40 Wall Street, New York.

Q. What legal training have you had, Mr. Polk?

A. I am a graduate of the Georgetown Law School, 1925, LL.B., and in '26, LL.M., and had about ten years' experience in the office of the Chief Counsel, Bureau of Internal Revenue. Do you want that experience in detail?

Q. Well, I think if you could give it, generally describe it, I would like to have that.

A. Well, I served in the review division, the interpretative division, and the appeals division in the Washington office of the Chief Counsel. In about 1932, I went to New York as the Chief Counsel's representative in that area, and was representative there until 1935, when I resigned and went with Whitman, Ransom, Coulson and Goetz on

(Testimony of James K. Polk.)

their staff. In 1938 I was admitted to partnership, and have been a partner in charge of the federal [1284] tax matters that Whitman, Ransom, Coulson and Goetz handle.

Q. Now, have you had some accounting training?

A. Yes, I am a graduate of Pace and Pace, and I have kept myself as current as possible in accounting matters. A great deal of tax work that I have done over my period of work with the government—and with Whitman, Ransom, Coulson and Goetz—has been intimately associated with accounting matters.

Q. You spoke of Pace and Pace. What is that?

A. That is an accounting school.

Q. In Washington, D. C.?

A. Yes, I think their name is now changed to Benjamin Franklin Institute or something of that sort.

Q. In what courts have you been admitted to practice?

A. Admitted to practice in the courts of the District of Columbia and the State of New York, the United States Courts, District and Circuit Courts of Appeal, in New York, and the District Court of Columbia, the Supreme Court of the United States, the Court of Claims, the United States Tax Court.

Q. Have you specialized in any field of law?

A. Oh, I have specialized in federal tax law from 1920.

(Testimony of James K. Polk.)

Q. And could you describe briefly your experience in that field? You have already spoken of your time in the Bureau. Subsequent to that time?

A. Well, after leaving the Bureau, and with Whitman, Ransom, Coulson and Goetz, I have been in charge of federal tax matters [1285] of their clients. Approximately 50 per cent of my time has been continuously devoted to public utility tax problems. That involves not only the review of tax problems as they arise, but the giving of advice in connection with the preparation and filing of returns, and with the handling of contests, of asserted deficiencies or claims for refund.

Q. Now do you seek to keep yourself conversant with developments in the tax field as they come along? A. I do.

Q. And what do you do with that object in view?

A. Well, I read all the releases of Commerce Clearing House in the federal tax field and of other tax publications, and I keep posted on legislative matters as the various revenue acts go through. That is since the original act went through Congress in 1921, and all the acts up to the present act. I have followed them through their legislative history. I have also been a member of the committee on taxes, and then the successor section of taxation of the American Bar Association from its organization, and I have been chairman of the committees in that section of taxation or counsel member to the present time. [1286]

(Testimony of James K. Polk.)

Q. You recall, of course, that there came a time when the firm of Whitman, Ransom, Coulson & Goetz was employed by the reorganization trustees in the Western Pacific Railroad reorganization?

A. Yes, sir.

Q. When and by whom were you advised that the firm had been employed?

A. About April 1, 1943. I was advised by my partner, Colonel Coulson, that we had been retained to advise in the preparation of the Federal tax return for 1942 and generally in tax matters.

Q. What work did you understand you were to be called upon to perform.

A. The usual work of tax counsel, that is, to supervise and advise in connection with the preparation of the return and filing thereof, and the giving of advice on tax matters as they were brought to me or I found them.

Q. In speaking of the usual employment and purpose of employment of tax counsel, what did you perceive to be that purpose in this case?

A. Well, it is my understanding of the function of tax counsel to advise in respect of the facts in any situation, the statutes, and the Bureau regulations and such matters to see that the lowest tax is paid to the Federal Government. I assumed that that was my function in connection with the Western Pacific situation. [1287]

Q. At that time had you known of the pendency of the Western Pacific reorganization?

(Testimony of James K. Polk.)

A. Yes.

Q. Did you learn of the decision of the United States Supreme Court in that reorganization?

A. Yes, I knew about it, within a day or so after it was issued.

Q. The date of record shown here being March 15, 1943. Did you know at that time what interests, if any, your firm represented in the reorganization?

A. They represented the Arthur Curtis James interests.

Q. When you undertook this work as tax attorney for the reorganization trustees, what did you then do.

A. Well, I knew nothing of the facts and background, and so my first step was to acquaint myself with what had happened, as fully as I could, in prior years. I phoned the corporation office, talked with Mr. Curry, asked him for the prior year files, and went back to the date of reorganization. He told me to get in touch with Mr. Nicodemus, who would send them over to his office. I did get in touch with Mr. Nicodemus and went to his office within the next couple of days and briefly discussed the fact that I was going to look into those papers with him and talk over some other matters that were entirely unrelated to the Western Pacific situation, and took the papers to my office and started a survey of the tax history of the group.

Q. And that was the source you just described from which you [1288] obtained the material to work with? A. Yes.

(Testimony of James K. Polk.)

Q. What if anything did you learn from your study of the background material with respect to the Federal tax history of the plaintiff corporation?

A. Well, I learned that from the time of the organization of the plaintiff corporation, from 1918 through 1941, consolidated returns had been filed, and from approximately 1930 to 1941 in the consolidated returns had been shown losses and no tax liability; that the operating company had had income in 1940 and 1941, but that the parent company continued to have losses and had had losses over the span of years certainly from 1930 to date. That is my recollection. I made desk notes of my review of the tax handling, the way the Bureau had closed the cases, as I went along; they were subsequently typed and went into the file.

Q. Did you make any arrangement in the spring of 1943 with respect to the employment of any person in connection with this tax work?

A. Yes, I did.

Q. What did you do in that regard?

A. I had found out that the returns for several prior years had been prepared by a Miss Valouch under the direction of Mr. Curry in the corporation office in New York.

Mr. Phleger: Just a moment. I ask that that be stricken [1289] out on the ground it is hearsay.

Mr. Clark: It is the conclusion of the witness, your Honor, under the direction of Mr. Curry.

(Testimony of James K. Polk.)

The Court: It does call for hearsay. I will sustain the objection.

Q. (By Mr. Adams): Go ahead, Mr. Polk.

A. I was told by Mr. Curry that the returns had been prepared in his office by Miss Valouch, and I was not satisfied that a return reporting approximately \$10,000,000 of taxable income should be prepared with only the single work of one person acquainted with taxes. So I suggested to Colonel Coulson that outside independent tax accountants' services should be secured. He agreed with me, and upon my recommendation I discussed with Mr. Frank Reilly the possibility of his doing this type of work. It was agreeable to him, and, accordingly, we arranged a conference in Colonel Coulson's office, at which were present Mr. Reilly, Mr. Nicodemus, Colonel Coulson and myself, and arrangements were made to have Mr. Reilly work with Miss Valouch in the preparation of the returns.

Q. What prior associations, if any, had you had with Mr. Reilly in tax work?

A. I had known Mr. Reilly since about 1937. He was tax accountant in the employ of the Consolidated Edison Company, and from 1940 on I had placed in his hands the preparation of the excess profits tax returns of the Consolidated Edison system and had [1290] worked with him in a review of the Bureau regulations and statutes, and I was entirely satisfied as to his qualifications as a tax accountant.

(Testimony of James K. Polk.)

Q. Mr. Polk, did you make any arrangements with respect to the manner in which the work would be handled? A. Yes.

Q. What were they?

A. The arrangements were that the return would be prepared at the corporation office at 37 Wall Street. The office there had just been in receipt of a large amount of unrelated papers, that is, they were not combined for tax purposes, from the West Coast, reflecting the balance sheet and the operations of the various companies on the West Coast, and they had to be reviewed, intercompany eliminations taken care of, and otherwise put into form for inclusion in the Federal tax return. I arranged that this work would be done by Miss Valouch and Mr. Reilly, who reported to me as they went along each tax problem as they encountered it, and the return was prepared over a period of six weeks, during which time they consulted with me and I advised in connection with the various income, deduction, and invested capital items.

Q. Did you prepare the 1942 Federal tax returns? A. Oh, no.

Q. Who did prepare them?

A. They were prepared, as I have described, by Mr. Reilly [1291] and Miss Valouch and whatever other help they had in the office over there. I do not know who typed the returns or the schedules.

Q. Did you do any of the accounting work in the preparation of the returns?

(Testimony of James K. Polk.)

A. None at all.

Q. What advice, if any, did you give with respect to the types of returns that should be filed?

A. In the course of the work, in connection with the preparation of the return, Mr. Reilly made the customary calculations on both consolidated and separate bases to determine which produced the least tax liability. These computations showed, as I recall it, that there was net tax advantage in the consolidated return reporting of approximately \$1,-500,000, and accordingly the returns were prepared that way.

Q. In that connection did you give advice as to the selection of the type of return to be filed under the circumstances?

A. I do not recall giving any specific advice. It was quite apparent which way produced the least tax liability.

The Court: You were not going to tell them to file one that cost a million and a half, obviously?

A. Certainly not.

Q. (By Mr. Adams): The record here shows, Mr. Polk, that the final returns for the year 1942 were filed May 15, 1943. Did you render any reports with respect to such returns? [1292]

A. Yes.

Q. Will you please state what you did.

A. It was arranged, I think, as to time by Mr. Curry or his office that a conference would be had in Mr. Nicodemus' office, and such a conference was

(Testimony of James K. Polk.)

had on May 18, 1943, and I took to that conference the desk notes which Mr. Reilly had prepared in the course of his work in the construction of the return schedules, and so forth, and there was a general discussion and explanation of the manner in which each item had been handled, I particularly remember that three major items were covered. They involved the consolidated return, the advantage over the separate return, which was apparent on the calculations, the change-over, which was recommended from retirement to depreciation basis in respect of the road accounts, and the possibility of a deduction for tax purposes arising out of the stock loss. There was also a recommendation that further work be done to back up the figures used in the returns since we had taken at face value figures that had been sent on from the West Coast, but without any analysis to see if they were proper or not.

Q. Did either Mr. Nicodemus or Mr. Curry inform you during the course of that conference on May 18 that they did not understand what you were discussing with them? A. Oh, no.

Q. There is in the record here a letter dated May 20, 1943, [1293] addressed by you to Mr. Curry, plaintiff's Exhibit 50. I ask that that be handed to the witness.

Now, Mr. Polk, referring to Plaintiff's Exhibit 50, did you write that letter at your own initiation?

A. Well, in the course of, or toward the conclu-

(Testimony of James K. Polk.)

sion of our conference in Mr. Nicodemus' office, it was suggested that the matters discussed be reduced to writing, and this letter was then prepared in response to that request for a written summary of the observations.

Q. What is the next thing you did in connection with the Federal tax work for the reorganization trustees?

A. The next thing was not until about the 1st of June, when I received a telegram and a phone call from Mr. Schumacher, who was in San Francisco. He stated that he had been going over with the company officials the letter of May 20, and that he wanted me to undertake the work recommended in that letter.

Q. Did you go directly to San Francisco?

A. No, I did not. I went first to Washington and I spent two days there with Mr. Reilly reviewing with the Bureau of Internal Revenue valuation division officials the Bureau requirements under Treasury MM-58 for the depreciation matter, and then entrained for San Francisco, and on the way I received a telegram from Mr. Schumacher asking me to meet him in Denver.

Q. Did you meet Mr. Schumacher there?

A. I did. [1294]

Q. Who was present at the conference with Mr. Schumacher in Denver?

A. Mr. Schumacher, of course; Miss Valouch, who had been out on the West Coast and was re-

(Testimony of James K. Polk.)

turning East with him; Mr. Reilly, Mrs. Polk and myself.

Q. The conference was held in the office car, was it not, of Mr. Schumacher?

A. They called it a business car.

Q. A business car? A. Yes.

Q. What was the subject matter of that conference?

A. Mr. Schumacher discussed the matters that were in that letter of May 20. He had a copy with him. And then he told me that it had been agreed that we should go ahead with the work recommended to be done in the letter in connection particularly with depreciation and that Mr. Elsey would provide me with whatever help was necessary. We discussed, as I recall it, a number of the physical properties of the road because we were to engage upon asset mortality study in order to complete this depreciation change-over.

Q. Did you next proceed to San Francisco?

A. I did.

Q. When did you first meet Mr. Charles Elsey?

A. The day I arrived there.

Q. And that was about when? [1295]

A. The 12th or 15th of June.

Q. 1943? A. That is right.

Q. What was the nature of your activities in San Francisco on that trip?

A. Well, there were two principal objectives on that trip. They were to assemble back-up material,

(Testimony of James K. Polk.)

particularly in support of the invested capital computations in the 1942 tax returns, and, second, to assemble enough information to know what election to make under Treasury MM-58.

Q. That had to do with change-over from retirement to depreciation accounting?

A. That is right.

Q. What discussions, if any, did you have in San Francisco in June, 1943, with respect to the subject matter of your letter of May 20, 1943, Plaintiff's Exhibit 50?

A. That was the letter which Mr. Elsey had when I met him for the first time in his office and the subject matter was generally discussed. There was some review of the stock loss situation, but that had not matured, and the principal discussion concerned the depreciation and the invested capital and other items.

Q. Did you also have discussions with other officers of the Western Pacific Railroad Company aside from Mr. Elsey at that time? [1296]

A. I did.

Q. With whom, please?

A. I had discussions with Mr. DeGraff, general auditor, Mr. Russell, his assistant, with Mr. Englebright, who was Mr. Elsey's assistant, Mr. Droit, the secretary of the company, Mr. Phillips, the chief engineer, Mr. Wyche, a statistical assistant to Mr. Englebright, Mr. Gloster, who is Mr. Phillips' assistant, and there may have been others, Mr. Gosney for one.

(Testimony of James K. Polk.)

Q. You were working on tax matters as counsel for a period of some days in the Western Pacific offices on that occasion? A. Yes, I was.

Q. Did you during the course of that visit also meet the trustees' counsel, Mr. Matthew, and discuss the tax matters with him? A. I did.

Q. At the time of such conferences what conclusion, if any, had you reached with respect of the advice ultimately given in connection with the taking of the stock loss?

A. I had not reached any conclusion different from that expressed in the letter of May 20. It was my judgment that the stock loss had not matured at that time for tax purposes.

Q. When was it that you decided to recommend the use of the stock loss in the Federal tax returns?

A. It was in the latter part of December, 1943.

Q. What, if anything, had meanwhile occurred on the basis of which you reached a decision to recommend use of the stock loss in the returns?

A. Well, the steps had been taken between the time of the entry of the order of approval of the plan that were required before the order of confirmation could be entered. The votes of security holders had been taken, and the entry of the order of confirmation and the expiration of the statutory period for appeal therefrom, and no appeal having been filed, it was in my judgment the determining factor, the identifiable event fixing the 1943 loss.

Mr. Adams: This record shows, I think counsel

(Testimony of James K. Polk.)

will agree, that the order of confirmation of the plan was made and entered October 11, 1943.

Q. Now when you arrived at your decision to recommend the use of the stock loss in the federal tax returns, did you discuss that matter at or about that time with anyone?

A. Well, I discussed it in New York with Col. Coulson before leaving for San Francisco. I left—

Q. Now before you pass to the leaving, then would you tell us so far as you can recollect it, what was the discussion you had with Col. Coulson in New York on that occasion?

A. Well, I reviewed with Col. Coulson the general principles of worthless stock, told him I thought that this stock had become worthless by act of the operation of law, and that it could be claimed as a deduction under the provisions of Section 23(g) 4 of the Internal Revenue Code. The colonel didn't think the deduction had too much prospect of allowance, but in any event, I told him I was going to recommend that it be claimed in the return for the year 1943.

Q. And this was shortly before you made another trip to San Francisco?

A. Yes, I left very early in January, the 4th or something like that, for San Francisco.

Mr. Adams: I shall not finish with the witness today, your Honor, but I can go further. Whatever your Honor's convenience [1299] may indicate is most desirable.

(Testimony of James K. Polk.)

The Court: I think you might go ahead a little further.

Mr. Adams: Very well.

Q. Now then, do you recall the date or approximate date when you arrived in San Francisco, in January, 1944?

A. I am afraid I can't. I know it was in the early part of January, but I have been here about fifteen times, and I have trouble keeping the dates straight.

Q. There is a paper in the record in this case, and various other things that we lawyers know who are in this lawsuit, indicating the date to be January 8, 1944. A. Yes.

Q. Now you did, while you were in San Francisco, prepare an opinion advising with regard to the use of the stock loss in the consolidated return?

A. I did.

Q. Who suggested that you render a written opinion?

A. I discussed the matter with Mr. Elsey and told him of my recommendation, and it was at his request that it was reduced to writing.

Mr. Adams: And I will ask that Plaintiff's Exhibit 54 be shown to the witness. (Document handed to the witness by the clerk.)

Q. Mr. Polk, referring to Plaintiff's 54, is this the finally delivered opinion that was written in response to Mr. Elsey's [1300] request?

A. Yes.

(Testimony of James K. Polk.)

Q. And now there has been some point made in the case of the fact that the signature of Whitman, Ransom, Coulson and Goetz to this opinion is the signature in the handwriting of Col. Coulson. Do you recognize it to be such?

A. No, I know it is not my handwriting.

Q. Well, we have agreed that it is Col. Coulson's signature—or the lawyers have. Now in connection with that matter, do you have any recollection with regard to how it came about that the opinion finally delivered emanated from the New York office of your office—strike that; it is not accurate.—emanated from your office which was in New York.

A. Yes.

Q. Well, please state your recollection in that regard.

A. Well, when it was requested that the opinion be prepared in writing and delivered at any early date to Mr. Elsey, I started to draft an opinion letter. I found that I did not have sufficient information in San Francisco. For one thing, I was under the impression that the stock of the operating company had been transferred on December 31. Mr. Droit told me that it had not been, or he would know about it; he was secretary of the company. Another thing, I wasn't entirely sure how much of the losses of the operating company had been availed of in prior consolidated return years; the sum of such losses would reduce the basis of [1301] the stock in the hands of the parent company, and

(Testimony of James K. Polk.)

reduce the loss that is allowable upon the worthlessness of its stock. So I prepared a draft of letter and sent it airmail to New York for check of the facts by my office there. I am sure that I discussed the matter over the telephone with Mr. Noneman, and Col. Coulson.

Q. Who was Mr. Noneman?

A. Mr. Noneman is a partner who specializes in federal tax matters, along with me, under my direction.

Q. Thank you. That is all of that letter.

Now while you were in San Francisco in January, 1944, did you have any discussions with respect to the adjustment of the book tax accruals for the year 1943? A. I did.

Q. And with whom did you have such discussions, and what was said?

A. The discussions were at several different conferences, but I talked the matter over with Mr. Elsey, Mr. DeGraff, Mr. Russell, Mr. Englebright; Mr. DeGraff was the general auditor, and the accounts, of course, were kept under his direction.

Q. And what is your best recollection as to what was said in those discussions on that subject matter of the adjustment of the book accruals for taxes?

A. Well, the adjustment for the book accruals was not particularly involved. All that had to be done there was to wipe out [1302] the amount accrued at the date the entry was passed, and credit operating revenues, since they had been charged in setting up the liability.

(Testimony of James K. Polk.)

Q. Is that what you would call a "reversal"?

A. That reversed the piecemeal entries that had been made over the eleven months. I do not believe the December entry had been posted.

Q. Now was any decision made at that time, when you were in San Francisco in January, 1944, with respect of the reversal of the tax accruals for '43?

A. Yes, it was decided that the proper thing to do would be to reverse the tax accruals for 1943.

Q. And who made that decision?

A. That decision was made by Mr. Elsey and Mr. DeGraff.

Q. Now do you know who prepared the 1943 tax returns? I am referring, of course, to the tax returns of the plaintiff corporation, being consolidated returns embracing the subsidiaries.

A. They were prepared in substantially the same manner in which the 1942 returns had been prepared. The draft material was forwarded from the West Coast to the New York office at 37 Wall Street, and there Miss Valouch, Mr. Reilly, Mr. Curry and whatever staff he had (of typists, and so forth) prepared the return. I was consulted as the work went along on the questions that arose.

Q. And would you say that your last statement was in answer to [1303] the question, "What work you did in connection with the preparation of those returns"?

A. I think so, with one addition; I know that

(Testimony of James K. Polk.)

it was at my advice that an additional extension of time was obtained, so that the depreciation election could be completed with the Commissioner of Internal Revenue before the actual filing of the return.

Q. Now during the preparation of the 1943 returns, do you recall any discussions you had either with Mr. Curry, Miss Valouch, or Mr. Reilly on that subject?

A. I cannot recall individual discussions. I know that there were discussions over the span that each return was being prepared.

Q. Now did you see and approve the 1943 federal tax returns before they were filed?

A. Well, I know I saw the returns, but I don't think that I approved them. I was consulted and the returns were prepared, and the tax accountants prepared the returns. I did not assume responsibility for the figures in them, or to approve them.

Q. Now when did you learn that the stock of the debtor company had been transferred by the plaintiff corporation to the reorganization committee?

A. Shortly after it happened, April 30, 1944.

Q. How did you learn of that fact?

A. In discussion with my partners.

Q. Now what effect, if any, did the transfer of that stock have [1304] on the federal tax work that you were doing for the trustees?

A. Well, it terminated the affiliated relationship

(Testimony of James K. Polk.)

which had theretofore existed between the parent corporation and the operating company and its affiliates.

Q. And did you discuss that subject with Col. Coulson?

A. Oh, yes, I discussed that over a considerable period before the transfer of the stock.

Q. And please state the discussion you had with Col. Coulson with regard to the effect on your federal tax work of that transfer of stock to the re-organization committee.

A. Well, I pointed out that the minute the stock was transferred and the affiliation was terminated, the availability of the stock loss carry-over into 1944 was also terminated; and the longer the affiliation could be kept in existence, the more use could be had of the stock loss carry-over.

Q. And what statement, if any, did Col. Coulson make to you in response to the views you expressed to him on that subject?

A. He said the termination of the bankruptcy proceedings was of paramount interest, and it could not be held open to take advantage of the tax loss.

Q. Now, Mr. Polk, when did you decide to recommend the type of federal tax return that should be filed for the year 1944?

A. Well, I knew the type of tax return that would be filed for 1944, insofar as the parent corporation and its affiliates, inclusion up to April 30, as soon as I knew the date of April 30. [1305]

(Testimony of James K. Polk.)

I mean, it is quite obvious that there would be no tax liability on such a return. As to the type of return which would be filed for the company and its affiliates for the remaining eight months of 1944, I could not determine that until after the income items for the entire year had been assembled, and alternative calculations could be made on separate and consolidated return bases, to see which produced the least tax liability.

Q. Now, Mr. Polk, do you know who prepared the 1944 tax returns, both the tentative returns that were filed March 15, 1945, and the final returns that were filed June 15, 1945?

A. I don't recall who prepared the tentative returns that were filed, but the final returns were prepared by Miss Valouch and Mr. Reilly, Mr. Curry was there, and I think in my own office.

Q. The record shows he came to your office on or about, early in June, 1945.

A. I mean the return, I think, was prepared in my own office.

Q. Now what work, if any, did you do in connection with the preparation of those returns for the year 1944?

A. My work was the same as for the previous or preceding years. As the various questions arose in the course of the preparation of the returns, I was consulted and advice was given. [1306]

* * *

Q. (By Mr. Adams): The record shows, Mr. Polk, in this case, that a claim for refund on ac-

(Testimony of James K. Polk.)

count of the taxes paid for 1942 was filed by the Western Pacific Railroad Corporation on or about March 9, 1945. What, if anything, did you have to do with the filing of the refund claim?

A. I had the refund claim drafted by one of the men in our staff, in our office, and gave it to Miss Valouch who, I believe, took it into Mr. Curry's office and had him sign it and file it with the Collector of Internal Revenue where the taxes were paid.

Q. Now bearing in mind the date, March 9, 1945, and the fact which is of record here that the New York office of the Western Pacific Railroad Corporation and Company was not closed until the end of that year, would that affect in any way your recollection as to the location at which these papers were submitted and filed, or this paper, rather?

A. No, I do not know where the physical signing of the claim for refund was done. I know that it was filed at the Collector's office in New York.

Q. Now do you recall when the Commissioner of Internal Revenue conducted the field examination of the federal tax returns for '42, '43, and the first four months of '44?

A. Those field examinations took place over a period of time in the spring of 1944 until about June of 1946. They were not carried on as a continuous activity, and the first—you just asked when. Do you want me to go ahead?

(Testimony of James K. Polk.)

Q. Yes, I think if you will give a general description it would help us along.

A. The internal revenue agent Leahy, of the agent's office in New York, came into my office, I think, the spring of 1944, and said that he had the 1942 return for audit and the '40 and '41 as well. I told him that a loss was going to be claimed in the 1943 which would have a carry-back effect into 1942, and he probably should audit '43 at the same time that he audited '42 and prior years. He agreed to that, but asked questions concerning the nature of certain deductions that appeared on the face of the returns for '42 and prior years and asked for analyses of reserves and matters of that sort. These were secured over a period of time and furnished him. They were secured from Mr. DeGraff in San Francisco. The audit did not become active until the latter part of 1945, and he concluded his examination and discussed with me his findings, proposed recommendations, sometime around June of '46.

Q. Well now, when, if you recall, did the matter of the stock [1308] loss first become a subject of discussion between you and the agent?

A. Well, as I just stated, I told him that the loss was going to be claimed in the 1943 return. He was aware of the nature of the claim from the beginning, but I did not discuss the loss with him until, oh, approximately six months before he completed his audit. In the meanwhile I had been en-

(Testimony of James K. Polk.)

gaged in assembling evidence and material, legal research, in support of the claim of deduction.

Q. Now I show you two documents, one marked Interveners' 90 for identification and entitled "Date of worthlessness of the Western Pacific Railroad Company's capital stock" prepared by Benjamin Graham, 52 Wall Street, New York 5, New York, April 18, 1946, which is a document beginning with a transmittal from Mr. Graham to your firm of April 25, 1946; and a report of Mr. Graham, 48 pages in length, with appendices. And I also show you the document identified as Interveners' Exhibit 90 for identification which is a report on "Worthlessness of Western Pacific Railroad Company capital stock in 1943," submitted to James K. Polk, Esq., Whitman, Ransom, Coulson and Goetz, 40 Wall Street, New York, dated April 12, 1946; which is also an extended document of 84 pages, and exhibits. (Handing to witness.)

I will ask you to state, please, Mr. Polk, what, if any, connection these exhibits I have just handed to you had to do with your presentation of the matter before the Commissioner of Internal [1309] Revenue's agent in New York.

Mr. Clark: We object to it on the ground it is incompetent, irrelevant and immaterial, your Honor; the tax matter is settled, the matter of the stock loss so far as this action is concerned, is fixed. Nothing further remains to discuss about it.

Mr. Adams: It is offered, your Honor, as a part of the work record of this witness, that is to say,

(Testimony of James K. Polk.)

his account of what he did. There has been an assertion here that the defendant took over the stock loss. We account for the participation of each witness who participated in this transaction. We have given the account of Mr. Ehrman and Mr. Elsey. Now I am presenting the account of the lawyer. It has to do with that. These reports themselves have to do with studies on the date of loss, as to which there is a controversy, since plaintiff's counsel keeps insisting that the date of loss was the date of the Supreme Court decision. We do not offer these reports as proving anything to the contrary, but as reports presented to the Commissioner of Internal Revenue in which the whole subject was exhaustively examined. It has to do with that.

Mr. Phleger: Your Honor, we have no objection to the statement of fact that the reports were made, but these are lengthy documents and we do not think the record should be extended. We have not expended the money to have them printed or photostated. [1310]

Mr. Adams: They were admitted on discovery and merely marked for identification after being examined.

Mr. MacKinnon: At this stage of the game I do not think they were offered in evidence. An objection was made to interrogating the witness as to what connection these reports had.

Mr. Phleger: Counsel said he intended to offer them.

(Testimony of James K. Polk.)

Mr. MacKinnon: The objection is clearly improper.

Mr. Phleger: We have no objection.

Mr. Clark: We object on the ground they are incompetent, irrelevant and immaterial.

The Court: If I understand the question correctly, and knowing lawyers and tax experts, he might talk for hours in answer to that question as to what connection these reports had with his work. All you are trying to show is he investigated the matter, secured other help, got other reports, as a tax man would do, and made his representations and arguments to the tax board. Is that about it? I mean to the Commissioner's office?

Mr. Adams: That is a fair statement, yes, your Honor. I am accounting for the work Mr. Polk did. This is a part of it.

The Court: Is anybody attacking his work?

Mr. Phleger: It was very satisfactory.

The Court: I do not see any necessity for this examination.

Mr. Clark: That is our point, your Honor.

The Court: I will assume, unless counsel indicates to the contrary, that the witness devoted himself effectively and [1311] efficiently and over a long period of time with the aid of assistants to presenting this tax matter to the Commissioner's office. Unless counsel indicate to the contrary, I will assume that that is so.

(Testimony of James K. Polk.)

Mr. Adams: There seems to be no demur, your Honor.

The Court: No.

Mr. Adams: Without asking the witness to give any detail of the work, I will ask him to sketch in the times during which that work was done, very briefly.

The Court: All right.

Q. (By Mr. Adams): Do you recall the approximate time when the field examiner concluded his work in connection with his examination of the returns for 1942, 1943 and the first four months of 1944?

A. Along toward the end of May, 1946.

Q. Were you informed of his proposed recommendation?

A. Yes, he informed me of his proposed recommendation.

Q. What was his proposed recommendation?

A. His proposed recommendation was that the loss be allowed as a 1940 loss, is the year in which the District Court had entered its order of approval in the bankruptcy proceeding.

Q. And I take it that had the loss finally been allowed for the year 1940, it would not have served any substantial advantage as a deduction in respect of the later war years?

A. There is some doubt about whether it could have had any effect [1312] in the year, 1942. It would have had no effect in any subsequent year,

(Testimony of James K. Polk.)

and the government would not have recognized any effect in 1942, the question there being, if you want me to sketch it, whether the net loss carry-over should be computed under the law applicable to the year to which the loss is carried or from which the loss originated.

Q. As I understand, the effect of your answer as to the year 1943 and following, if it had been finally determined that the loss took place in 1940, then it would not have operated in any wise as a deduction for 1943 and subsequent years?

A. That is correct.

Q. Following your learning of the proposed recommendation of the field examiner, what was your next step?

A. My next step was to take the matter up with the Office of Internal Revenue Agent in charge to whom the report would be addressed, and my first step in that direction was to get the required powers of attorney on file.

Q. What relation does having powers of attorney have to do with your checking the matter up with the Internal Revenue agent in charge?

A. Well, an investigating internal revenue agent can discuss a matter with anybody, whether he has a power of attorney or not, because he is merely examining for facts; but the conference requirements of the Bureau are that when conferences are to be held, powers of attorney must be filed by an authorized [1313] representative.

(Testimony of James K. Polk.)

Q. And did the internal revenue agent in charge afford you a hearing?

A. He did. I had an informal rather than a scheduled conference under Bureau procedure with Mr. Krigbaum, Internal Revenue agent in charge, and his assistant. [1313A]

Q. What was the subject matter of the hearing?

A. Just before the field man had completed his report, I addressed a letter to Mr. Krigbaum in which I outlined the facts concerning the taxpayer's claim for deduction, but without argument, and I appeared before Mr. Krigbaum and refreshed his recollection concerning the factual statement and argued that the loss was properly a 1943 loss and not a 1940 loss. Mr. Krigbaum stated that he was not at all sure that the agent might not be right in his proposed recommendation, and I then suggested that the matter be referred to Washington for an advisory ruling, and Mr. Krigbaum said that he would refer it there if I could find out if they considered the type of matter that they would give an advisory ruling on.

Q. Did you then confer with the office of the Commissioner of Internal Revenue in Washington?

A. I did. I talked with Mr. Nichols, Mr. Gayton, and others, and they stated they would be glad to give an advisory ruling if Mr. Krigbaum's office requested it.

Q. What was the next thing you did?

A. Well, I told Mr. Krigbaum of that and Mr.

(Testimony of James K. Polk.)

Krigbaum then forwarded the case to Washington. This took some little span of time.

Q. Did you have any conference with the office of the Commissioner of Internal Revenue in Washington after the advisory ruling had been requested by the Internal Revenue agent in [1314] charge?

A. After I found out the case had reached Washington I talked with Mr. Nichols, who was head of the post-audit review section, having the New York area, and reviewed with Mr. Nichols the facts in the case and the contention of the taxpayer that this was the 1943 deduction. Mr. Nichols then told me that he would refer the case in the usual course to his office force for consideration and preparation of an advisory ruling, and he promised me that in the event there was any disagreement with the positions of the taxpayer, that they would afford me a formal hearing.

Q. Following that did you learn of any action that the office of the Commissioner in Washington had taken?

A. The next thing I learned about the case was when I returned from San Francisco in December.

Q. December, 1946?

A. 1946. Mr. Herskowitz of the Internal Revenue agent's office called me up and said that they had received an advisory ruling stating that it was the opinion in Washington that the revenue agent's recommendation should be sustained.

Q. What did you do next, Mr. Polk?

(Testimony of James K. Polk.)

A. I went down to Washington to find out about it because I had been promised a hearing in the event an adverse ruling were to be given, and I found out that the ruling had originally been drafted in favor of the taxpayer's contention, but it had [1315] been changed in the front office without knowledge that the conference had been promised and had not been afforded me. So they agreed that if the matter were resubmitted to them, they would afford me a hearing.

Q. And were you in fact afforded a hearing?

A. I was.

Q. Was that a formal hearing?

A. That was a formal hearing.

Q. And when was it held?

A. On February 11, 1947.

Q. And where?

A. In the office of Mr. Edingfield, Technical Advisor to the Commissioner of Income Tax.

Q. That is in the Treasury office in Washington?

A. In Washington, yes.

Q. Who was in the hearing?

A. Mr. Edingfield presided, and Mr. Nichols, and some man whose name I cannot remember from the Securities Valuation Section, were present representing the Government; Mr. Noneman, Mr. Whiteside and I represented the taxpayer.

Q. And Mr. Whiteside is a professor in the University of Cornell law school and an associate from time to time of your firm?

(Testimony of James K. Polk.)

A. That is right.

Q. Will you please tell us what took place at the conference. [1316]

A. Well, I first reviewed the facts in considerable detail, both as to the origin of the loss, the basis, then I discussed what I thought were the applicable cases which sustained the taxpayer's contention that the deduction was a 1943 deduction. I discussed at some length the Haskins & Sells, Bretey and Graham reports, which established that the stock had value or was evidence that the stock had value, up to certainly April of 1943, when the preferred stock was delisted. I then urged that the Bureau should allow the deduction as a 1943 deduction. Mr. Edingfield at that point stated that he thought that there was considerable merit to the taxpayer's contention, but that the interests of the Government might best be protected by litigating the matter. I told Mr. Edingfield I thought this was a case that was particularly subject to administrative settlement, rather than litigation. Mr. Edingfield suggested—

The Court: Mr. Adams, I don't like to interrupt, but while this case is important and you should have all reasonable time to present it on both sides, there are other litigants that are entitled to be heard in these courts and are waiting to be heard, and I just cannot see what purpose is served by these long discussions as to what took place in a conference in Washington over subject matter,

(Testimony of James K. Polk.)

when the results are before the Court, and it doesn't seem to serve any useful purpose.

Mr. Adams: Your Honor, I am responsible for this; may I try and shorten that up in that case? I appreciate your [1317] Honor's suggestion.

Q. Mr. Polk, you have just come to the question of settlement. Now, at that conference, will you state what proposal of settlement was discussed, and tell us briefly about that. That is what we have to account here for.

A. Well, Mr. Edgingfield asked what sort of a settlement could I suggest, and I said, "Well, the case might be settled by leaving the returns as filed, stand, unchanged." He asked me if I would put it in writing, and I told him I would get authorization and put it in writing.

Q. And you spoke of Professor Whiteside, and I did also. It is a fact, is it not, that Professor Whiteside worked with Colonel Coulson throughout the reorganization of the Western Pacific, or the latter part of that period?

A. Yes, I had Mr. Whiteside present to be sure that I accurately stated facts regarding the reorganization.

Q. Now, at this time, the time of this conference that you had in Washington, where was Colonel Coulson?

A. He was in San Francisco.

Q. Did you discuss the submission of the proposal of settlement with him?

(Testimony of James K. Polk.)

A. I immediately phoned him in San Francisco and told him of this development which had taken place.

Q. And did you receive a telephone call from San Francisco in respect of the proposal of settlement? And please state what [1318] that was, briefly, and whether or not through that telephone call you received authorization to go ahead.

A. I did, two or three hours later, receive a telephone call from San Francisco. I was advised by Colonel Coulson and Mr. Elsey that the directors had been canvassed and that I was authorized to submit the written offer of settlement, which I read over the telephone to them.

Q. Now, was anything said during either of these telephone calls as to the advisability or inadvisability of informing the plaintiff corporation about the offer of settlement?

A. Nothing was said.

Q. Did you thereupon file the offer of settlement with the Commissioner?

A. I did, the same afternoon.

Q. And that document is in the record.

I think all counsel will agree that a copy of it appears as a part of Plaintiff's Exhibit 68, being a document dated February 11, 1947?

Mr. Phleger: It is so agreed.

Q. (By Mr. Adams): Now, when, if at any time, did you learn that the proposal of settlement had been referred by the Commissioner of Internal

(Testimony of James K. Polk.)

Revenue to the Internal Revenue agent in charge
in New York? A. Approximately March 19.

Q. And when with respect to that date did you
notify the plaintiff [1319] corporation of the sub-
mission of the proposal of settlement?

A. I think the letter to Mr. Curry was dated
April 2.

Mr. Adams: And may the record show, by con-
sent of counsel, that the letter is Plaintiff's Ex-
hibit 68?

Mr. Phleger: Agreed.

Q. (By Mr. Adams): Did you thereafter dis-
cuss the matter with representatives of the plain-
tiff corporation? A. I did.

Q. What was the occasion, if any, for the delay
in notifying the plaintiff corporation of the sub-
mission of the proposal of settlement?

A. Well, it was my first impression that the
taxes which had been paid, and which would be
paid, being the dollars of the company, that my
responsibility was to them and not to the corpora-
tion. But I knew of the pending litigation, and
after giving the matter consideration, I came to
the conclusion that they should be notified. And
when I came to that conclusion, I notified them.

Q. Now, had anybody at any time requested
you to refrain from advising the plaintiff of the
submission of the proposal of the settlement to
the Bureau? A. No, sir.

Q. Did any representative of the plaintiff ever

(Testimony of James K. Polk.)

tell you that they thought the proposed settlement was disadvantageous as regards settlement with the Government? [1320]

A. I don't think I understand the question.

Q. Did any representative of the plaintiff corporation ever tell you that they did not believe the proposed settlement was a good one?

A. No, they did not.

Q. Now, Mr. Polk, what did you perceive your functions to be as tax counsel engaged in this work?

A. I thought my function was to advise concerning Federal tax matters in such a way as to produce the least tax liability for the group.

Q. Now, do you recall the commencement of the stockholders' action in New York, which we call the Van Kirk action, in the middle of the year 1946?

A. I was aware of it shortly after it was filed.

Q. Shortly after it was filed, did you examine the bill of complaint in that lawsuit?

A. I did not examine the bill of complaint, although certain portions of it were brought to my attention, and I did examine them with Mr. Shaw.

Q. Now, after you found out about that lawsuit in which there were controversies between the parties as to who was to get the so-called tax savings, did you believe that there was any possible conflict as far as your representation of the group was concerned?

(Testimony of James K. Polk.)

A. No, I believed my employment was to obtain the least tax [1321] liability possible under the facts and the Bureau of Internal Revenue laws and regulations.

Q. And did you believe it was any function of yours to give advice to any member of the group with respect to possible claims, one against the other? A. No.

Q. Now, did you have any other further knowledge with respect to the Van Kirk claim than what is set forth in the bill of complaint? A. No.

Q. Have you ever heard, or had you ever heard of such a claim prior to the time you learned about it through that complaint? A. I had not.

Q. Now, I hand you a copy of a letter identified as Plaintiff's Exhibit 7 upon the depositions, being a letter of September 27, 1946, addressed to your firm by Mr. Curry as president of the plaintiff corporation, together with a copy of your letter of October 4, 1946, addressed by you to Mr. Curry as such president, being Plaintiff's Exhibit 8-B.

And I ask that 8-A be handed up, please. And I will offer 8-A. It is a letter of October 5, 1946, from Mr. Curry as president of the corporation, to Mr. Nicodemus and Mr. Osborn, enclosing 8-B, which is a copy of Mr. Polk's letter to Mr. Curry. I shall offer these documents in evidence, your Honor; the letter of September 27, 1946, from Mr. Curry to the firm [1322] reads:

(Testimony of James K. Polk.)

"In order to protect any equitable interests that the Western Pacific Railroad Corporation may have in the reserves set up by the Western Pacific Railroad Company on account of tax deductions, as well as any refunds of tax payments arising from claims filed with the corporation, we propose to file a bill of complaint in the District Court of the United States for the Northern District of California, Southern Division, asking that these reserves and refunds, if any, be impounded, pending an accounting and an equitable determination, to ascertain what, if any, interests the corporation may have therein.

Appreciating that your firm has acted as tax counsel for both the company and the corporation in the filing of consolidated tax returns and in the proceedings now pending before the Internal Revenue Department, we would, of course, not wish to take any steps which would in any way prejudice the claims made in these returns. We would therefore appreciate your advise on this, and would be glad to have any suggestions you may make for the full protection of the interests of the corporation therein. [1323]

I would be glad to arrange a conference between your Mr. Polk and our counsel to discuss the matter further.

Yours very truly,

President."

(Testimony of James K. Polk.)

Plaintiff's 8-A is a letter of transmittal from Mr. Curry to Mr. Nicodemus, and Mr. Osborn, dated October 5, 1946, transmitting a copy of Mr. Polk's reply to the letter I have just read, and Plaintiff's 8-B is Mr. Polk's reply, addressed to Mr. Curry, President of the Western Pacific Railroad Corporation, October 4, 1946:

"Dear Sir:

This refers to your letter of September 27, 1946, addressed to this firm. The undersigned has been acting as tax counsel in connection with pending tax questions arising under the Federal consolidated returns made by the Western Pacific group for the period ended April 30, 1944, and prior open years.

In presenting the issues as to these tax matters to the Treasury Department, it will be necessary to develop the facts fully, and the Treasury Department is clearly entitled to any relevant information. There would therefore seem to be no reason why any development of facts in a [1324] separate litigation instituted by your company in the United States District Court in California would present necessary embarrassment in connection with the tax questions."

The Clerk: No. 37.

Mr. Adams: I offer the three documents as Defendants' Exhibits 37-A, -B and -C.

(Letter, September 27, 1946, Curry to Whitman, Ransom, Coulson & Goetz; October 5,

(Testimony of James K. Polk.)

1946, Curry to Nicodemus & Osborn, and October 4, 1946, Polk to Curry, were received in evidence and marked Defendants' Exhibits 37-A, -B and -C.)

Q. (By Mr. Adams): Now, Mr. Polk, with respect to the proposal of settlement that had been submitted on February 11, 1947, in Washington, when did you learn that that proposal had been communicated to the Revenue Agent in charge in New York?

A. That was approximately March 19, as I stated, 1947.

Q. And thereafter, with respect to that proposal of settlement, when did you learn that the Internal Revenue Agent in charge in New York had acted upon it?

A. That is sometime around the middle of June, 1947.

Q. Did you advise the plaintiff and the defendant in this suit—that is, the Western Pacific Railroad Corporation and the Western Pacific Railroad Company—of the action taken by the Internal Revenue Agent in charge? A. I did.

Q. And was that action favorable to the proposal?

A. It was; it contained a recommendation for a settlement of the case in accordance with the proposal.

Q. Approximately when did you learn of that case? Can you fix the time approximately?

(Testimony of James K. Polk.)

A. It is around June 15 of 1947.

Q. Was it in the same month that you notified the plaintiff and the defendant?

A. Yes, immediately thereafter.

Q. Tell the Court—you spoke of that as favorable action—what it came to; that is to say, was the action of the Internal Revenue Agent in Charge final or was it an intermediate step that went forward?

A. That was an intermediate step. The case had then to go to post-audit review in Washington for final action.

Q. Did you thereafter learn of the final action being taken on the proposal? A. I did.

Mr. Adams: Your Honor, that final action is exemplified by the papers attached to the stipulation on file in this court.

The Court: Yes.

Mr. Adams: Your Honor will recall the first of the letters from the Commissioner was dated August 13, 1946.

Q. When, if you recall, Mr. Polk, did you learn of the Commissioner's action on August 13, 1946?

A. August 14.

Mr. Phleger: You mean 1947.

Mr. Adams: I do.

The Witness: August 14, 1947.

Q. (By Mr. Adams): Now, Mr. Polk, prior to the discussion which you had at the office of the Commissioner of Internal Revenue on February

(Testimony of James K. Polk.)

11, 1947, had there been any prior discussion on your part with respect to any possible settlement?

A. No, sir.

Mr. Adams: I have no further questions.

Cross-Examination

By Mr. Phleger:

Q. Mr. Polk, are you tax counsel for the defendant? A. I am.

Q. You and your firm? A. That is right.

Q. When did you cease to be tax counsel for the plaintiff?

Mr. MacKinnon: Your Honor, we submit—

Mr. Phleger: Now—

Mr. MacKinnon: I can make an objection. I certainly can do that. I object to the question on the ground that it calls for a conclusion of law. Your Honor will determine the question. He was representing the affiliated group. He is now asking when he ceased to be counsel for the plaintiff corporation. His only representation was as a representative of the [1327] affiliated group. That is a question of law for your Honor to determine.

The Court: I will overrule the objection.

The Witness: Well, I do not recall any questions on Federal taxes being asked me after the 1945 return was filed. There have been questions asked me on State taxes. Mr. Curry sent such a question to my office within the last six months.

Mr. Phleger: Will you read the question again, Mr. Reporter.

(Testimony of James K. Polk.)

Mr. Adams: I submit it is responsive, your Honor.

Mr. Phleger: I do not think so.

Q. Are you still tax counsel for the plaintiff?

A. I still am, as far as I know, for the years covered by the powers of attorney which are on file with the Government.

Q. Do you still consider yourself tax counsel for the plaintiff with respect to all the matters that are in controversy here?

Mr. Adams: If your Honor please——

Mr. Phleger: Just a minute now.

Mr. Adams: I can make an objection.

Mr. Phleger: I object to objections which are suggestionized in their form.

Mr. Adams: That is a sound objection, but it is made before the objection has been heard.

Mr. Phleger: It applies to the last objection.

Mr. MacKinnon: I do not think there was anything suggestive [1328] in the form of my objection. I have a right to state the basis of my objection in any objection I make.

Mr. Adams: May I hear the question to which I was about to make an objection?

(Question read.)

Mr. Adams: I object, your Honor, upon the score of calling for a conclusion of law and its immateriality as to any issue involved in this case, it appearing on the facts before your Honor who

(Testimony of James K. Polk.)

are the parties and who are their representatives.

The Court: I should think a lawyer should be able to say whether he represents a client or not. I do not think that calls for any conclusion of law. I will overrule the objection.

The Witness: I have not been called upon at all by the plaintiffs, as I have stated, with the one exception that I mentioned, oh, for two years.

Mr. Phleger: I submit that is not responsive. Mr. Reporter, will you read the question.

The Court: I think that the subject of the inquiry is not whether the corporation has made any legal inquiries of you for information, but whether or not there is any relationship now in existence of a contractual or other nature in which you are employed by the corporation.

A. I know of no contractual relationship by which I am now [1329] retained by the corporation.

Mr. Phleger: I will narrow the breadth of that.

Q. Are you the plaintiff's attorney?

A. I—I do not think so.

Q. When did you cease to be the plaintiff's attorney?

A. Well, when they ceased asking for advice or coming to me. There was no written contract or annual retainer at any time. I acted on requests for information or on work to be done as it was given to me, and when they stopped giving me the work, I assumed that I stopped acting as their attorney.

Q. Well, when was that date?

(Testimony of James K. Polk.)

A. My recollection, I have told you, except for this one matter Mr. Curry referred to me, I do not think I have had anything to do for the corporation for two years.

Q. That date would be what in 1945—or 1947?

A. 1947.

Q. Can you fix the date?

A. I cannot.

Q. As a matter of fact, all of these negotiations for settlement with the Government that you related were all conducted in the name of the plaintiff corporation, were they not?

A. Oh, that is correct.

Q. By yourself as attorney in fact?

A. Under power of attorney.

Q. Yes. [1330] A. Right.

Q. And in its name?

A. And in the name of the common parent corporation, yes.

Q. That is the plaintiff corporation?

A. Right.

Q. Did you have a power of attorney from anyone else?

Mr. Adams: You mean in relation to the matter now in controversy?

Mr. Phleger: Correct.

A. Yes, I had powers of attorney from the other members of the affiliated group.

Q. But you conducted all the negotiations in

(Testimony of James K. Polk.)

the name of the plaintiff corporation under the power of attorney which you have testified you prepared and submitted to Mr. Curry for signature, is that correct? A. That is correct.

Q. I think you testified that you made the offer in behalf of the plaintiff corporation and the affiliated corporations in February of 1947, and that you notified the plaintiff corporation for the first time sometime in April, is that correct?

A. That is correct.

Q. Where was Mr. Curry's office during all this time?

A. I think it was in our office at 40 Wall Street.

Q. Well, you know it was, don't you?

A. Yes. [1331]

Q. How far from your office?

A. Oh, it was six or eight offices removed. I can't tell you how far.

Q. 50 or 60 feet? 40 or 50 feet?

A. Well, probably.

Q. 40 or 50 feet away from your office. Now, did you keep Mr. Curry currently advised of these other matters that you have testified to, the writing of the first Krigbaum letter, the second Krigbaum letter, and the Nunan letter?

Mr. Adams: Could you give the witness an identification of something that you have names for and he has not been—

The Court: He may be able to place them without taking a lot of time to refer to the exhibits. If the witness needs them he may have them.

(Testimony of James K. Polk.)

Mr. Adams: It is just a question of identification.

The Court: Do you know what Mr. Phleger is referring to?

A. I can find out very quickly. The first Krigbaum letter—

Q. (By Mr. Phleger): —is the general explanation.

A. That is the May 25 or thereabouts letter?

Q. Yes.

A. And the second Krigbaum letter—

Q. The first Krigbaum letter is May 31, 1946; the second Krigbaum letter is a year later, May 19, 1947. Did you advise Mr. Curry of the sending of those letters at or about that time or [1332] at all? A. No.

Q. Did you advise Mr. Curry about the sending of the Nunan letter at or about its time?

A. Is that the February 11 letter?

Q. Correct.

A. I advised him of the sending of that letter on April 2, 1947.

Q. Now, you stated in your direct testimony that you had to have the power of attorney in order to deal with Krigbaum, didn't you?

A. I did.

Q. Have you in mind that you did not get the power of attorney until a month after you wrote the first Krigbaum letter?

A. The letter was addressed to Mr. Krigbaum

(Testimony of James K. Polk.)

but was delivered to Mr. Leahy. Mr. Leahy used it in the recital of facts, in the report that he had in the course of preparation. It had to be addressed to his chief, and not to the Revenue Agent.

Q. You wrote that letter and signed it in the name of the plaintiff corporation before you had the power of attorney, didn't you? A. I did.

Q. I will direct your attention to the 1942 return. When did you decide to file a consolidated return for the year 1942?

Mr. MacKinnon: I object to the form of the question. He [1333] said, "When did you decide." There is no evidence that the witness did make the decision.

Mr. Phleger: Well, he can answer it. It is a proper question.

Mr. MacKinnon: I do not think it is proper. That is why I objected to it.

The Court: I will overrule the objection.

A. Well, sometime between April 1 and May 15, 1943, the calculations were made which showed the advisability of the consolidated return, the advantage of the consolidated return over the separate return, and advice was given at that time, of course, to file on the basis which reflected the lower tax.

Q. (By Mr. Phleger): And you place that time as what time in 1942?

A. I cannot place the time by day.

Q. No.

A. I know that it was along toward the latter

(Testimony of James K. Polk.)

part of the work that was done in the preparation of the return, because the calculations could not be made until some progress had been made in converting back figures to tax figures.

Q. And Reilly made those figures, did he, for you? A. He did.

Q. Have you got the figures?

A. I do not know. They were summarized in the letter of May 20, but I do not believe that the actual calculations have been located. [1334]

Q. When in 1943 did you first begin to take an interest in the tax affairs of the plaintiff corporation and its affiliated corporations?

A. I received a memorandum of inquiry from Colonel Coulson sometime around the 15th of March, 1943, in which he stated that he understood that the returns were being prepared by some woman over in the corporation office and asked me to look into the matter. I phoned the office, talked with someone there—it is my recollection it was Mr. Curry—he said that that was the fact, and the papers had just been received from the West Coast, and it would be six weeks or a couple of months before the return preparation would be completed.

I made a memorandum of that on the bottom of the paper and sent it back to Colonel Coulson and my—I think that answers your question.

Q. That memorandum, Mr. Polk, reads as follows:

(Testimony of James K. Polk.)

"Colonel Coulson:

As I understand the procedure in the New York office, only the lady referred to has any part in the preparation of the return. She now has separate company data and will require several weeks to prepare consolidated schedules. She 'confers' with accounting firm, but Mr. Curry says they are too impoverished to hire accounting help. They paid on 3-15 a quarterly payment of \$1,000,000. [1335]

No decision has been reached as to depreciation treatment. I will follow this up if you so direct in about four weeks."

You recall that, do you not?

A. I do.

Q. And do you recall then a memorandum from Mr. Coulson to you: "Better follow up"?

A. I know that that notation is on there. I have no independent recollection of it, sir.

Q. At that time you or your firm were not the attorneys for either the defendant or the plaintiff or the trustees in bankruptcy, were you?

Mr. Adams: You mean in tax matters, Mr. Phleger?

Mr. Phleger: Yes, in tax matters, in these matters. A. No, sir.

Q. You became attorney after you made this inquiry? A. That is right.

Q. Do you know, Mr. Polk, of any similar case to this, that is, where the parent's stock loss in a subsidiary was used in a consolidated return to eliminate the tax for the affiliated group?

(Testimony of James K. Polk.)

A. No, I have no personal knowledge.

Q. Well, you never heard of any such case, did you?

A. Well, the way you stated it, it is a rather usual circumstance. [1336]

Q. Well, you state it. You are an expert.

A. I know, but you state where the parent's loss has been used to offset system income, that is a rather usual circumstance.

The Court: He means the parent's loss of its own stock in a subsidiary.

Q. (By Mr. Phleger): Yes, its ownership in the subsidiaries.

A. I know of no such case.

Q. As a matter of fact, this case could not have happened except for a change in the law in October 1942, could it?

A. No, it could not have.

Q. What was that change in the law which made this possible?

A. Well, there was a very unfair situation in consolidated return accounting up to that point that section 23(g)(4) was designed to correct. You see, under consolidated returns intercompany transactions are eliminated, and where a parent corporation puts out its cash for a subsidiary company and then the subsidiary company becomes worthless, if you eliminate the worthlessness as an intercompany transaction, there has been, in the usual case, a deprivation of capital, a loss of

(Testimony of James K. Polk.)

capital and no reflection for tax purposes, and that was corrected by the insertion into the Internal Revenue Code of Section 23(g)(4).

Q. So that my statement is correct, is it not, that this particular tax handling became possible because of the new law passed [1337] in October of 1942?

A. It was the Revenue Act of 1942, yes, sir.

The Court: Perhaps we might take a recess at this time.

(Recess.) [1337-A]

Q. (By Mr. Phleger): Mr. Polk, when was the first time it was decided to use the stock loss?

A. In late December 1943, I had reached the conclusion that I would recommend its use. In January of 1944 I did recommend its use and the decision was made to use it.

Q. Who made the decision?

A. Mr. Elsey, Mr. DeGraff.

Q. Where was it made?

A. Made in San Francisco.

Q. When was it decided to file a consolidated return including the defendant corporation for the first four months of 1944?

The Court: You mean the defendant corporation?

Mr. Phleger: A consolidated return of the plaintiff, including the defendant corporation for the first four months of 1944.

(Testimony of James K. Polk.)

Mr. Adams: Your Honor, I understand I have a running objection to the characterization due to the fact that we represent the reorganized company, which came into existence the first of 1945, and questions of this sort are subject to such a running objection.

Mr. Phleger: Well, Mr. Adams, the returns were filed in the name of the defendant corporation, were they not?

Mr. Clark: The plaintiff corporation.

Mr. Adams: The 1944, the first four months of 1944 were filed in the name of the plaintiff, and the last eight months [1338] were filed by the defendant corporation.

Mr. Phleger: Yes, but the participance in the first four months was in the name of the defendant corporation, was it not?

Mr. Adams: As it had always been throughout the trusteeship.

Mr. Phleger: Well, that is the question. Would you read the question?

(Previous question read by the reporter.)

A. I am not sure I can answer that. I can't tell you when I decided to recommend that.

Q. When was that?

A. That was shortly after the transfer of the stock, April 30, 1944, which terminated the affiliation.

Q. To whom did you make the recommendation?

(Testimony of James K. Polk.)

A. The recommendations were ultimately made to Mr. Elsey, Mr. DeGraff, Mr. Curry prepared the returns in accordance with them, and so forth.

Q. And they made the decision?

A. The decision to file the returns were, of course, made by the company.

Q. Yes. Now who made the decision to file a claim for refund for 1942?

A. Decision?—I prepared the claim for refund, and saw that it was finally filed.

Q. Well, who made the decision to file it? [1339]

A. Well, I guess that decision was made by Mr. Curry, who signed it.

Q. Well now, Mr.—

A. Well, you asked who made a decision to file it. I recommended and prepared the claim, which is a technical step to protect the interests of the group in the transaction, and sent it forward for execution by the proper signing officers, and it was executed and filed.

Q. Well, you prepared it on your own initiative, did you not? A. Certainly.

Q. And when you prepared it, had you discussed it with anyone in the corporation, the matter? A. No.

Q. And you sent it forward with the request that it be signed, did you not?

A. I did.

Q. Now you have stated at some length as to the circumstances surrounding the submission of

(Testimony of James K. Polk.)

the so-called Nunan offer, which was in February, 1947. Other than the power of attorney which you had received a year or more earlier, had you any authorization from the plaintiff corporation to make that offer in its name? A. No.

Q. During this entire period, did you give any advice to any officer of the corporation as to what its right might be as against any other officer of the affiliated group arising out of the [1340] filing of consolidated returns? A. No.

Q. Did you ever advise anyone representing the corporation, the plaintiff, that it could elect to file or not file consolidated returns?

A. Will you read that to me?

(Previous question read by the reporter.)

Mr. Phleger: No, strike that out.

Q. Did you ever advise anyone representing the corporation during this period it had the option to file or not file consolidated returns?

Mr. Adams: I object to the question, your Honor. Our contention being that there was no option under the circumstances, and it was obligatory on the part of plaintiff corporation to file returns which were filed.

The Court: Well, of course that is argument in the matter.

Mr. Adams: That is right. I state it in my objection.

The Court: All the question pertains to is a question of fact. Overruled.

(Testimony of James K. Polk.)

A. Well, I don't believe that I advised anyone in that form. I did advise in respect specifically of the 1942 tax returns, that the consolidated basis was a great deal less than the separate basis. It was quite apparent to everybody that we could have filed on either basis.

Mr. Phleger: Now will you read the question, Mr. Reporter, [1341] please?

A. I would like to complete my answer by stating that the same type of disclosure of advantage of consolidated over separate return was made for the year '43 and for the four months of '44.

Mr. Phleger: Would you read my question, please?

(Previous question read by the reporter.)

Mr. Adams: May we have the answer, your Honor?

Mr. MacKinnon: Yes, I would like to hear the answer.

The Court: You may during this period, Mr. Phleger?

Mr. Phleger: I mean during this entire period involving the returns for these years.

The Court: All right. Do you wish the answer, gentlemen?

Mr. MacKinnon: Yes.

Mr. Phleger: Well, he didn't answer this question.

Mr. MacKinnon: I assumed he did. I take the position that he did answer it. I think it is a

(Testimony of James K. Polk.)

responsive answer. It may not be what counsel wishes, but that is immaterial.

The Court: Well, if they want it, you may as well read it.

(Previous answer read by the reporter.)

Mr. Phleger: I submit the question has been answered. The question is, "Did you, during this period, with respect to this period, advise the corporation that it had the option to file or not file consolidated returns?"

Mr. Adams: I submit the question was answered directly.

The Court: Well, the first part of the question is in [1342] answer to it. He said he didn't.

Mr. Phleger: Well, if that is the answer, that he didn't—

Mr. Adams: I take it, your Honor, the answer was in respect of the privilege to explain the witness' answer.

The Court: Well, of course, he gave part of it —part of it is his conclusion and opinion, as to whether everybody assumed something or not. That is, of course, his opinion and conclusion.

Mr. Phleger: That is right. But do I understand your Honor to interpret his answer is that he said—

The Court: He said he didn't do it in that form, which means that he didn't do it.

Mr. Phleger: All right.

The Court: Because your question was a specific

(Testimony of James K. Polk.)

question, I am not attempting to shut you off; you can pursue it as far as you want to.

Mr. Phleger: Well, the witness hears your interpretation of the answer, and I accept it.

The Witness: Well, I didn't mean my answer to be so interpreted.

Q. (By Mr. Phleger): Well, suppose you answer the question, then?

Mr. Adams: Move to strike out that remark of counsel's; it is inappropriate to this record.

The Court: Well, the question was a narrow one. The [1343] attorney wanted to know whether you advised anyone connected with the corporation that the corporation, during this period of time, had the option to file or not to file any affiliated returns.

The Witness: Well, your Honor, that was perfectly apparent when I discussed with them—

The Court: It may be. Now that is a matter that I am going to have to decide. All he wants to know is whether you, from your own mouth, by word of mouth or in writing, specifically so told any of the officers of the plaintiff corporation. Now there are a lot of lawyers here that are going to carry it further, I suppose. But that you can answer.

The Witness: Very well.

The Court: And you don't have to be afraid to answer it because it may be there is some other evidence to show that they did not know that. But all

(Testimony of James K. Polk.)

he is asking you is whether you told them that. That is all.

The Witness: Well, when I discussed the advisability of filing one or the other, it was perfectly apparent that they understood that they could have filed either of them.

Mr. Phleger: I move that be stricken out and that the witness answer the question.

The Court: Yes, it may go out. That still may come into the case, but all you are being asked is whether, at the time you told them that. [1344]

A. Very well, sir.

Q. (By Mr. Phleger): Will you answer the question?

A. I have answered it as well as I can, sir.

Mr. Phleger: Will you read the question, Mr. Reporter?

(Previous question read by the reporter.)

The Court: It is not a question of whether you considered it necessary to do that; but in fact, did do it.

A. Well, I certainly considered that I had.

Mr. Phleger: Well, I move that that be stricken out.

The Court: Yes. That may go out.

Mr. Phleger: And that he answer the question.

A. It is my belief that I did.

Mr. Phleger: Now I would like the deposition of this witness, page 1985.

(Testimony of James K. Polk.)

(Deposition produced by clerk.)

Q. (By Mr. Phleger): I read to you from your deposition, page 1985, about eight lines from the bottom of the page:

"Q. In connection with the preparation and filing of the 1944 tax, did you advise the corporation that the corporation could elect to file a non-consolidated return for that year?

"A. I did not."

Do you recall that testimony?

A. Well, I don't recall all that I said on deposition, no, sir.

Q. Well, was that statement true when it was made? [1345]

A. Well, it is my present recollection, as I have tried to testify that Mr. Curry, an officer of the corporation, was advised of the type of return and reason for filing that type of return, as against a separate return, as each return was prepared—'42, '43, and '44. Now that is the fact; what that amounts to I cannot say. I am not attempting to testify—

Q. Well, you have been asked the direct question as to whether you advised them—that is, the plaintiff corporation—that they had the option or election to file or not to file a consolidated return. Now what is your answer?

Mr. MacKinnon: I submit, your Honor, that that is a different question than was asked previ-

(Testimony of James K. Polk.)

ously, and I object to it on the ground that, if it is purported to be the question that was previously asked, the previous question, if I recall, was "anyone connected with the plaintiff corporation." Now he says the "plaintiff corporation."

Mr. Phleger: Well, I see no difference.

The Court: I will overrule it.

Mr. MacKinnon: I see a material difference.

The Court: Overruled.

The Witness: You are not excluding Mr. Curry in that connection?

Mr. Phleger: No.

A. I gave no written opinion on that to anyone. I was not asked the specific question, so far as I can recall, by anyone. [1346] It was discussed and decided as an available alternative method of filing in each year, and the decision was to file on the basis which produced the least tax.

Q. And that is the only answer you can make to my direct question as to whether you advised?

A. That is.

Q. And you want the record to remain in that shape. You know during all this time that the plaintiff corporation could elect to file a separate return if it saw fit, did you not?

A. Well, I would have so advised. There are lots of periods during this time that you are talking about when they could not have, sir. You realize that this was not a continuing new election each year. It was something that came up by way of

(Testimony of James K. Polk.)

the commissioner's authorization at varying dates, so there were considerable periods when there was no election available. Having once filed the consolidated returns, you were bound by it.

Q. Having made that qualification, will you answer the question?

Mr. Adams: I object to the question as stated.

The Witness: I just can't answer your question. It is not so, that they had a free election all during this period.

Q. (By Mr. Phleger): Is it not a fact that you knew that at each time a consolidated return was in fact filed for 1942, 1943 and 1944, that the corporation at the time of filing had an election not to file a consolidated return but an individual return? You knew that, didn't you? [1347]

Mr. Adams: Your Honor, I object to that. I contend the statement in the question is inaccurate. That is an issue in this case. Your Honor appreciates one of our contentions is directed to the contrary, and counsel is asking of this witness a question which is an issue of law before your Honor.

The Court: He is only asking him as to what his knowledge was in the matter. Overruled.

The Witness: I think at the time each return was in fact filed that there existed the election to file either separate or consolidated returns.

Q. (By Mr. Phleger): Mr. Polk, when in your opinion did it become clear for the first time that the tax loss would be accepted by the government?

(Testimony of James K. Polk.)

A. August 14, 1947, sir. I do not mean to be facetious, but this was a doubtful item and it was not until the Bureau had finally allowed the settlement that I knew that we had the benefit of it.

Q. As a matter of fact, you considered any litigation about the tax benefits premature prior to that date, isn't that right?

Mr. MacKinnon: That is objected to, your Honor, on the ground it is irrelevant and immaterial to any issue in this case.

Mr. Adams: And this witness' opinion on a question of law of that sort is wholly irrelevant, your Honor.

Mr. Phleger: He is your attorney, acting for both parties at this time. [1348]

The Court: I do not think it is necessary to argue it. I think it is within the reasonable limits of proper cross-examination. Overruled.

The Witness: May I have the question read.

(Question read.)

A. I considered any estimate of the amount of savings premature prior to that date.

Mr. Phleger: I would like the witness' deposition, please, page 2496.

Q. I read now from your deposition, page 2496, about eight lines from the bottom. It has to do with a conference in which the settlement with the government was being discussed:

"Q. Were you discussing in those conferences the amount which is the subject matter of the lit-

(Testimony of James K. Polk.)

gation in California as affected by the settlement?

"A. That is not quite clear to me, sir.

"Q. What was the relationship between the subject matter that you described as having been discussed at this conference and the litigation in California?

"A. I think I was raising the question that any action was premature until the liability to the government was determined. You cannot calculate any savings until you know several factors, and one of the most important ones is the liability under the returns as filed."

Did you give that testimony that I have just read?

A. Yes, sir.

Q. Was it true when given? A. Yes.

Q. Is it true now? A. Yes.

Q. On your direct testimony—

Mr. MacKinnon: I want to submit the very next question and the very next answer, which was not read.

Mr. Phleger: I will be glad to read them.

The Court: You can take that up on redirect if you wish.

Q. (By Mr. Phleger): Mr. Polk, on your direct testimony you testified that you, after some thought on the subject, decided that you would advise the plaintiff corporation of the offer of settlement which you had made in its name and as its attorney in fact on February 11, 1947, and that you thereupon

(Testimony of James K. Polk.)

wrote a letter to the plaintiff corporation so advising it under date of April 2, 1947; do you recall that testimony?

A. Yes.

Q. Did you write that letter?

A. I dictated the letter.

Q. How did you dictate it?

A. I dictated it to Mr. Noneman.

Q. Over the telephone? A. That is right.

Q. Where were you at the time? [1350]

A. I was in San Francisco.

Q. So you dictated this letter from San Francisco to your partner in New York and he wrote the letter and signed your name, is that right?

A. May I see the letter? I thought it was signed with the firm's name, but it may be my name.

Mr. Adams: Plaintiff's Exhibit 68, I believe.

The Court: That is just a copy of it.

Mr. Phleger: Yes, the copy shows signature by James K. Polk, if it is a correct copy.

Mr. Clark: It is conceded to be correct, your Honor.

The Witness: I do not suppose it is incorrect. I do not know.

Q. (By Mr. Phleger): This is the letter that you read over the telephone from San Francisco with the request that it be sent, is that not so?

A. Yes, yes, that is so. But I mean as to signature, whether it is James K. Polk or Whitman-Ransom, I do not know.

Q. It is your letter, isn't it?

(Testimony of James K. Polk.)

A. Yes, it is my letter.

Q. Did you dictate this letter over the telephone from San Francisco after conference with the attorneys in this litigation?

Mr. Adams: May I have that question read?

(Question read.)

The Witness: You mean on the subject matter of the letter [1351] or just in point of time?

Q. (By Mr. Phleger): Both.

A. It was after conference with Mr. Matthew and Mr. Adams, but the conference was not on the subject matter of this letter.

Q. It was about this litigation in part, wasn't it?

A. Oh, yes, yes.

Q. And after you had conferred about this litigation, you concluded then that you had better advise the plaintiff corporation?

A. In point of fact, that is correct.

Mr. Phleger: That is all.

The Court: Any questions?

Mr. Clark: Just a few, your Honor.

Cross-Examination
(Intervenors)

By Mr. Clark:

Q. Mr. Polk, did you get Mr. Coulson's authorization before you prepared the January 11, 1944, opinion which is in evidence in this case?

A. Approval of what, sir?

Q. Did you get Mr. Coulson's authorization be-

(Testimony of James K. Polk.)

fore you prepared the January 11, 1944, opinion which you have testified you gave to Mr. Elsey?

Mr. MacKinnon: I object to it on the ground it is irrelevant and immaterial to any question in the action.

Mr. Clark: I will submit the objection, your Honor. The witness testified under direct examination—

The Court: I will overrule the objection. [1352]

The Witness: I can best answer that by relating the exact facts as I recall them.

Q. (By Mr. Clark): Will you please answer the question?

A. Well, I did not get Col. Coulson's approval to anything, sir.

Q. I asked whether you got his authorization before you prepared the opinion which you gave the defendant company.

A. You mean authorization to give them an opinion?

Q. Yes, sir. A. No.

Mr. Clark: May it please your Honor, I will offer in evidence a copy of telegram, James K. Polk to R. E. Coulson, dated January 10, 1944, having been marked Interveners' Exhibit 118 on deposition.

Mr. MacKinnon: May I see it, please?

Mr. Clark: The authenticity of which has been conceded.

Mr. MacKinnon: I object to it on the ground

(Testimony of James K. Polk.)

it is irrelevant and immaterial to any issue in the action.

Mr. Clark: The only portion of the telegram I am concerned with, your Honor, reads as follows:

"As basis for closing 1943 book entries, letter requested from firm as to effect of stock loss deduction in consolidated return on railroad company tax liability stop I will prepare letter if you authorize by wire."

We will submit the offer.

The Court: It may be introduced. [1353]

(The telegram referred to was thereupon received in evidence and marked Interveners' Exhibit No. 20.)

Q. (By Mr. Clark): At that time, Mr. Polk, did Mr. Coulson instruct you that the opinion should be held before becoming effective until cleared by him?

Mr. MacKinnon: I object to it on the ground it is irrelevant and immaterial to any issue.

Mr. Clark: I will submit it.

The Court: I do not know exactly what you are getting at. Are you making some distinction between the lawyers in the same firm?

Mr. Clark: I do not intend to. I intend to show there was no distinction, your Honor. There has been testimony in this case that Mr. Polk was the person who was relied upon, and that he had a certain conception of his duties. Also in his direct examination Mr. Polk testified the only reason the

(Testimony of James K. Polk.)

opinion was held up or sent to New York, or rather, clearance from New York was requested was because he did not have certain data out here. My point is it was cleared with Col. Coulson, the head of the firm, and it was a firm proposition.

The Court: Overruled.

Q. (By Mr. Clark): Did Mr. Coulson instruct you to hold up the opinion until he cleared it from New York?

A. I recall an arrangement, but I recall no instructions.

Mr. Clark: We will offer in evidence, if it please your [1354] Honor, a memorandum dated January 13, 1944, signed J. K. P., which is conceded to be Mr. Polk's initials, which is heretofore described as Interveners' Exhibit 178 on deposition, the only part of which I am interested in reading as follows:

"There was delivered to Mr. Elsey the letter of January 11 to be held by him per instructions of Col. Coulson until Mr. Elsey had telegraphic clearance from Col. Coulson in New York."

Mr. MacKinnon: I object to the letter on the ground it is irrelevant and immaterial to any issue in the action, and I state again to your Honor, that this is a situation where he takes two documents—these are only two out of many—and offers them. So if this extraneous matter is going in, there is no other alternative than to meet it.

The Court: Mr. MacKinnon, you have told me that a great many times during the trial of this

(Testimony of James K. Polk.)

case, and I am not going to admit or make ruling admitting or excluding evidence on the basis of some threat that that will cause the other side to produce any documents that you consider proper in product any documents that you consider proper in the case, and if it is proper and material I shall admit it.

Mr. MacKinnon: I am objecting to it on the ground it is irrelevant and immaterial.

The Court: I will overrule the objection.

(The document referred to was thereupon received in [1355] evidence and marked Interveners' Exhibit 21.)

Q. (By Mr. Clark): Mr. Polk, directing your attention to the conference at Denver, or rather, the meeting at Denver in June of 1943 with Mr. Schumacher and Miss Valouch in this business car of the railroad which you testified to in your direct examination, will you state whether or not at that time you advised Miss Valouch concerning the allocation of 1942 taxes in accordance with the rule then followed by the Securities and Exchange Commission?

Mr. Adams: Your Honor, may I have that question read?

(Question read.)

A. It is my recollection that there was some discussion of the allocation of taxes, and that I called attention to the U-45 rule of the Securities

(Testimony of James K. Polk.)

and Exchange Commission, and said that when I got back east—I was going to San Francisco—when I got back east I would check further into the matter, particularly as to the rules of allocation approved by the Interstate Commerce Commission, the prescribed system of accounts or individual rulings if any existed.

Q. At that time were you familiar with rule U-45 B 6?

A. I have on my deposition testified that I was familiar with the version of it which I had in my own file. If that is the same as the rule which now exists, I am familiar with it. I furnished the copy of the text with which I was familiar.

Mr. Clark: Now, may it please your Honor, I will ask counsel [1356] for a stipulation that the following releases of the SEC, being numbers 4806, in the matter of the Consolidated Electric and Gas Company; 4829, in the matter of Consolidated Electric and Gas Company and the Islands Gas and Electric Company; and 4444, in re Consolidated Electric and Gas Company and Islands Gas and Electric Company, and release 5535, in re Cities Service Company, Cities Service Refining Company. I will ask for the stipulation that they were received, that is, copies of them, by the office of Whitman, Ransom, Coulson and Goetz on or about the dates the releases bear, these being cited in the briefs which have been filed before your Honor.

(Testimony of James K. Polk.)

Mr. Adams: Is that in a deposition?

Mr. Clark: That is in the deposition, and it was so conceded.

Mr. MacKinnon: What page?

Mr. Clark: I can furnish you with the page later, subject to correction.

Mr. Adams: Well, it is stipulated, subject to correction.

Mr. Clark: Will you so stipulate, Mr. MacKinnon?

Mr. MacKinnon: No, but I won't stipulate they came to the notice of Mr. Polk.

Mr. Clark: I am not asking for that. I am simply asking for a stipulation that those were received by the firm of Whitman, Ransom, Coulson and Goetz on or about the date of the releases, which range from January 3, or rather from June 1, 1943, [1357] through January 3, 1945.

Mr. MacKinnon: I will accept it subject to the qualification that if I don't find such stipulation in the deposition, I withdraw it. They represent it is in the deposition.

Mr. Clark: That is satisfactory to us, your Honor, and that is all for this witness. [1358]

* * *

JAMES K. POLK

resumed.

Mr. Adams: I assume the cross-examination has been completed. May I have the exhibits, please,

(Testimony of James K. Polk.)

handed in by the interveners upon the cross-examination of Mr. Polk? What I have reference to were the documents that were referred to in the stipulation obtained that they were in the files of Whitman, Ransom, Coulson & Goetz.

Mr. Clark: Those SEC papers, Mr. Adams?

Mr. Adams: Yes.

Mr. Clark: I didn't have them marked or offered, because they are cited in the briefs as legal authority.

Mr. Adams: May I have them?

Mr. Clark: You may certainly have them, the four of them.

(Handed to counsel.)

Mr. Adams: This refers, your Honor, to the SEC release described by Mr. Clark upon his cross-examination of the witness, or releases, rather, being releases dated July 28, 1943, Holding Company Release No. 4444; June 1, 1943, Holding Company Account Release No. 4329; January 3, 1944, Holding Company Account Release No. 4806; and January 3, 1945, Holding Company Release No. 5535. [1359]

Redirect Examination

By Mr. Adams:

Q. I will hand the documents to the witness and ask the witness to tell me the time, if at all, when any of these releases first came to his attention.

(Testimony of James K. Polk.)

A. It is my recollection that they were brought to my attention at the time of the taking of my deposition in New York in this proceeding, and that at some time after the institution of the Van Kirk action in New York, a summary of one of them was brought to my attention in connection with a law memorandum prepared by Mr. Cavanaugh.

Q. Your deposition was taken, I take it—well, the record shows—in the year 1948, and referring to the Van Kirk action, by that you mean the litigation commenced in the middle of 1946 in New York? A. That is right.

Q. And prior to that time, that earlier date, had you ever had any knowledge concerning these releases or any of them? A. I had not.

Mr. Adams: Now, your Honor, referring to the portion of the deposition read upon the cross-examination by plaintiff's counsel, I desire to read what immediately follows, two questions, two answers.

Mr. Levy: What page is that?

Mr. Adams: Page 2497:

“Q. What were you referring to when you said ‘Any [1360] action was premature?’

A. Any action to recover a tax saving. It is impossible to compute the savings until you know what the tax liability is.

Q. Were you suggesting that the corporation's action could be defeated as premature upon that ground?

(Testimony of James K. Polk.)

A. Not at all. I was merely making the point that the case was still unsettled and that there was no way of saying what tax dollars belonged in any year."

Q. Do you recall giving that testimony upon the taking of your deposition, Mr. Polk?

A. I do.

Q. And were the answers which you then gave correct? A. They were.

Mr. Adams: Now may I see the exhibits, please, offered by interveners, the telegram of Januray 10?

The Court: Interveners' No. 20.

Mr. Adams: Thank you, your Honor.

(Handed to counsel by the clerk.)

Mr. Adams: Your Honor, at this time I offer as Defendants' 38-A a telegram from Mr. Coulson to Mr. Polk of January 11, 1944, sent from New York and addressed to Mr. Polk, care of Charles Elsey, the Western Pacific Railroad Company, San Francisco.

(The telegram referred to was received in evidence and [1361] marked Defendants' Exhibit 38-A.)

Mr. Adams (reading):

"Your telegram tenth received"—

Mr. Clark: Just a moment, your Honor. How is that identified on the deposition?

Mr. Adams: Oh, thank you. Interveners' 70-A.

Mr. Clark: Will you wait just a moment.

Mr. Adams: Surely.

(Testimony of James K. Polk.)

Mr. Clark: Very well.

Mr. Adams (reading):

"Your telegram tenth received. Have wired Hart my tentative plans. Ask Mr. Elsey's office to try and arrange return space streamliner for February fifth. No success so far this end. Stock of operating company was not transferred to committee on December 31 owing to Delaware litigation. Think letter as to effect of stock loss deduction on consolidated return should be released from this office if possible. Suggest you draft and forward airmail. Hope you are having a pleasant vacation."

And I offer as Defendants' 38-B a telegram of January 15, 1944, addressed from Mr. Coulson to Mr. Charles Elsey, President, Western Pacific Railroad Company, San Francisco, sent from New York. [1362]

(The telegram referred to was received in evidence and marked Defendants' Exhibit 38-B.)

Mr. Adams (reading):

"We have reviewed opinion letter"—

Mr. Clark: The deposition number, please.

Mr. Adams: Oh, thank you. 71.

Mr. Clark: Very well.

Mr. Adams (reading):

"We have reviewed opinion letter of January 11 left with you by Mr. Polk. Have made some minor typographical changes, but approve substance and conclusions. Revised signed copy being mailed today to substitute for copy left with you."

(Testimony of James K. Polk.)

The balance of the telegram does not relate to the opinion.

It will be stipulated, I think, that as upon the deposition, these telegrams were sent and received?

Mr. Clark: No doubt about that. The authenticity is conceded as to all these exhibits,—that one being signed "Coulson," I believe?

Mr. Adams: Both of them being signed "Coulson." Right.

Mr. Clark: Right.

Q. (By Mr. Adams): Now, Mr. Polk, have you ever known of a case in which a member of an affiliated group whose loss has been included in a consolidated return, with resulting tax advantage to other members of the group, but with no [1363] tax disadvantage to the loss company, has been compensated for joining in the return, that is, where such loss company has been compensated for joining in the return?

Mr. Phleger: Just a moment. I object to that upon the ground it is incompetent, irrelevant and immaterial, not within the scope of either the direct or cross-examination of the witness, an entirely different question.

The Court: Do you want this witness to decide this case for me?

Mr. Adams: Counsel for the plaintiff asked the witness a very broad question whether he ever heard of a case like this one.

Mr. Clark: Oh, no, that was not the question.

(Testimony of James K. Polk.)

The Court: He did not ask any questions along that line. He asked him whether he ever heard of a case where the affiliated return resulted in no taxes because the parent company was enabled to take the loss, the complete loss of its holding in the subsidiary company.

Mr. Adams: I take it, your Honor, this question is of a similar nature to that.

The Court: It is similar in that it is a question that involves taxes. That is as far as I can see. [1364]

* * *

The Court: I will sustain the objection. I think it is completely improper.

Mr. Adams: Your Honor, I have just one further question, somewhat like the last one. The last question asked the witness was if he had known of a case in which payment had been made for the tax advantage. That is the question to which objection was made and your Honor sustained the objection. Now, then, the next question varies slightly from that because the question was asked, "Have you ever heard of a claim," and I want to ask this one question:

Q. Mr. Polk, prior to the time that you learned of the stockholders' litigation in New York that was instituted in New York in 1946, had you ever heard of a claim on the part of a member of an affiliated group whose loss had been included in a consolidated return, with resulting tax advantage to other

(Testimony of James K. Polk.)

members of the group, but with no tax advantage to such loss company, to be compensated for joining in the return?

Mr. Phleger: I object to that upon the ground it is incompetent, irrelevant and immaterial and not within the [1368] scope of either the direct or cross-examination.

Mr. MacKinnon: May I make one more statement and I will sit down. I think this question is relevant, and I think the prior question was, on the basis of the discharge of this witness' responsibility to the plaintiff. If he did not believe that the plaintiff had any right to any share in the tax savings, then certainly his standard of conduct would be very different than if he did believe he had a right. If he knew or had come across a case of that type, then I think his standard of conduct with respect to the plaintiff would be a very different standard than it would be if he had never heard of any such claim and he had never heard of any compensation having been paid.

The Court: I think it is entirely incompetent what the witness' view or knowledge or effect of what he was doing was.

Mr. MacKinnon: That has been put in issue.

The Court: I do not conceive that it is. It certainly does not meet any evidence that has been presented on behalf of the plaintiff or the intervenor.

Mr. MacKinnon: It meets the question as to

(Testimony of James K. Polk.)

cross-examination with respect to the failure to notify from February 11 to April 2.

The Court: Yes, but that only goes to the manner in which this matter was handled, not with respect to any motive. I do not see that there is any question of motives involved in it at all. Anyhow, I think the question is generally [1369] objectionable on the ground stated, and I will sustain it.

Mr. Adams: I have no further questions of Mr. Polk.

The Court: Anything further, gentlemen?

Mr. Phleger: No.

Mr. Clark: Nothing from us, your Honor.

Mr. Adams: At this time, your Honor, I offer as Defendants' Exhibit 39 a memorandum identified as Interveners' Exhibit 232 upon the deposition, and I will ask counsel to look at that and agree with me, if we can, upon a statement in regard to it.

Will it be stipulated that this memorandum, which carries a pencil notation upon it, "November 22, 1944," is a memorandum that was made in New York at or prior to that time by Miss Valouch, and that the memorandum was produced from the tax files in New York that were examined upon the taking of the depositions?

Mr. Clark: And also, as the exhibit shows, that the memorandum was handed to Mr. Engelbright of the defendant company on November 22, 1944.

Mr. Adams: Yes, that may also be stipulated.

(Testimony of James K. Polk.)

May I have the stipulation of my statement? [1370]

Mr. Phleger: If that is the fact, all right. I think it is so short you might read it to the court.

Mr. Adams: I think I shall, but I want to get it authenticated right before I read it.

Mr. Clark: We will concede your statement.

Mr. Adams: The memorandum reads, your Honor:

"Approximate tax savings account worthlessness WPRR Company stock in 1943 (consolidated basis). 1942 carry-back \$4,000,000; 1943, \$8,000,000; 1944, carry-forward \$3,000,000."

Underneath that in parentheses:

"Four months, total \$15,000,000."

And the initials:

"M.C.V."

All of that I have read so far being in typewriting, and then in the handwriting of Miss Valouch,

"Copy handed to Mr. Engelbright November 22, 1944."

Mr. Engelbright is the assistant to the president identified by Mr. Elsey.

My particular purpose in offering this document at this time is in response to the showing with regard to the refund claim for 1942 which was filed five months after the date when this memorandum was made and filed in New York.

(Document referred to was thereupon received in evidence and marked Defendant's Exhibit 39.) [1371]

* * *

ROBERT E. COULSON

called as a witness on behalf of the defendant, sworn.

The Clerk: State your name to the Court.

A. Robert E. Coulson.

Direct Examination

By Mr. Adams:

Q. Will you please state your business and your business address?

A. Lawyer, 40 Wall Street, New York.

Q. How long have you been engaged in the practice of the law? A. Something like 35 years.

Q. And you are a member of the firm of Whitman, Ransom, Coulson and Goetz, with its offices at that place? A. Yes.

Q. How long have you been a member of the firm? A. Slightly over 30 years.

Q. Have you specialized in any particular field of law?

A. No, I have been engaged in general business and corporate practice during the period.

Q. When did you first meet Mr. Arthur Curtiss James?

A. To the best of my recollection, in 1919. I can't fix it more closely.

Q. And in what connection? [1372]

A. He became a client of our office shortly after its organization.

Q. And was it in connection with the law work

(Testimony of Robert E. Coulson.)

being done in the office for Mr. James that you met him? A. Yes.

Q. And did you thereafter, yourself, engage in legal service for Mr. James? A. Yes.

Q. How long did you continue to represent him?

A. Until his death in 1941.

Q. Now, Mr. Coulson, did you participate in the Western Pacific reorganization proceedings?

A. Yes.

Q. In what capacity?

A. I was counsel for the A. C. James Company.

Q. And that was from the beginning of the proceedings?

A. Well, the A. C. James Company didn't intervene at the beginning of the proceeding, but it came in before the Interstate Commerce Commission, to the best of my recollection, some time in 1936. The petition was filed in '35.

Q. From the time—

A. May I complete my answer?

Q. Yes, pardon me.

A. (Continuing): And a claim was filed by the A. C. James Company in the bankruptcy court in San Francisco in the Northern District [1373] of California, Southern Division, shortly after the petition was filed in 1935.

Q. And from the time that the A. C. James Company became a party to the reorganization proceeding, did you represent it as a party in the reorganization proceedings? A. Yes.

(Testimony of Robert E. Coulson.)

Q. And continued to do so throughout the proceedings until they were concluded?

A. Subject to the qualification that I acted as a member of the reorganization committee from the fall of 1943 until the consummation of the reorganization at the end of '44.

Q. Well, now, in speaking of that, Mr. Coulson, you are speaking of an additional relation which you had to the reorganization, are you not?

A. There was no termination of the relation of the office as counsel for the A. C. James Company.

Q. Were you at any time a director of the plaintiff corporation, the Western Pacific Railroad Corporation? A. Yes.

Q. And during what period were you a director of that company?

A. To the best of my recollection, from about 1934 until about February, 1942.

Q. Now in February, 1942, you resigned and your resignation was accepted?

A. Yes. [1374]

Q. And was Mr. Carman's resignation as a director accepted about the same time?

A. At about the same time.

Q. Now to your knowledge did the James interests have any representation on the Board of Directors of plaintiff corporation after resignation of Mr. Carman and yourself? A. No.

Q. You have said you were a member of the reorganization committee?

(Testimony of Robert E. Coulson.)

A. That was a committee, your Honor, that was provided for in the plan of reorganization and constituted during the latter part of the preceedings.

Q. Who were the other members, Mr. Coulson?

A. Mr. Frederick H. Ecker was chairman of the Metropolitan Life Insurance; Mr. Frank C. Wright, Reconstruction Finance Corporation—their railroad expert was a member, and I was the third member.

Q. And who designated you for such membership?

A. The designation was a joint designation by the Railroad Credit Corporation and the A. C. James Company, which was as provided in the plan.

Q. And the committee selected your firm to be its counsel? A. Yes.

Q. Now do you recall that your firm were retained as tax counsel by the reorganization trustees in the Western Pacific [1375] reorganization?

A. Yes.

Q. When were they retained?

A. Well, it occurred in the spring of 1943, and to the best of my recollection not very long after the Supreme Court decision of March 15, 1943.

Q. Were you in charge of that tax work?

A. No.

Q. Who was in charge of it?

A. Our partner, Mr. James K. Polk, who was in charge of the tax work in the office, the prior witness.

(Testimony of Robert E. Coulson.)

Q. Did you supervise Mr. Polk's activities in his work as a tax lawyer in this matter?

A. No.

Q. Did he keep you generally informed as to the work that he was doing? A. He did.

Q. Who decided what advice should be given in respect of tax matters involved in that work of your firm for the reorganization trustees?

A. Mr. Polk took the responsibility for the decision of the work being done by him and his associates in his department.

Q. Now who made the decision to recommend that consolidated federal tax returns be filed for 1942? A. Mr. Polk. [1376]

Mr. Phleger: Just a moment. If you know.

Q. (By Mr. Adams): Yes, if you know, surely.

A. I do know that Mr. Polk wrote a letter in the spring of 1943. I can't fix the date, but I saw the letter before it was sent.

Mr. Adams: Plaintiff's 50, please.

(Document produced by the clerk.)

Q. (By Mr. Adams): Mr. Polk, I show you Plaintiff's Exhibit 50, a letter dated May 20, 1943, (handing to witness), and I ask you if that is the letter to which you referred in your answer of a moment ago. A. Yes.

Mr. Phleger: I don't want to interrupt, but that is the May 20 letter?

Mr. Adams: Yes.

(Testimony of Robert E. Coulson.)

The Witness: The letter shown me is the letter of May 20, 1943, signed by James K. Polk and addressed to Mr. M. J. Curry, in the New York office at 37 Wall Street.

Mr. Phleger: I don't want to interrupt, but the returns had already been filed.

Mr. Adams: Well, I think that is an interruption and certainly has no reference whatever to the question I asked. The witness in his answer referred to a letter, and I produced the document to see if that is the letter he referred to.

Mr. Phleger: I am sorry. I just want to—I thought the [1377] question was who gave the advice about the filing of the consolidated returns for 1942, and he said Mr. Polk, and then he cites a letter written after the date.

Mr. Adams: Your Honor, I would like to proceed with my examination. It will be simpler.

The Court: All right.

Q. (By Mr. Adams): Mr. Coulson, when did you first learn of the possibility of using the stock loss in the federal tax return?

A. It was at or about the time of the letter of May 20, 1943, was written.

Q. Who informed you?

A. Mr. Polk discussed that matter, and it is referred to in the letter.

Q. And will you state to the best of your recollection the substance of your discussion with Mr. Polk about that at that time?

(Testimony of Robert E. Coulson.)

A. Mr. Polk told me that he felt that there was a substantial possibility of claiming a substantial loss on the part of the holding company because of the finding under the plan that the stock was worthless, and that when the plan was consummated, it would disappear as a worthless security. At the time I questioned whether, with an unlisted stock of that kind, he wouldn't have serious difficulty in establishing the year of loss. That is to the best of my recollection the conversation that occurred.

Mr. Adams: Now may I have Plaintiff's 50 once more, Mr.—

Q. You just looked at Plaintiff's 50, didn't you, Mr. Coulson?

A. If that is the letter of May 20, 1943. I didn't notice your notation on it.

Q. Yes. Now did you see Plaintiff's 50, the letter of May 20, 1943, before it was sent?

A. To the best of my recollection, I did.

Q. Now when, if you know, was the first time it was decided to recommend that the stock loss be used in a federal tax return?

A. It was either, so far as my own knowledge, it was either determined some time in December of '43 or January of '44, to recommend that to Mr. Elsey.

Q. And who, if you know, made the recommendation to Mr. Elsey? A. Mr. Polk.

Q. Did you have any discussion at or about that time of the book treatment to be afforded the federal tax accruals? A. Yes.

(Testimony of Robert E. Coulson.)

Q. And please state when, and with whom, as well as you can remember, and what the discussion was.

A. To the best of my recollection, I discussed with Mr. Polk, whether it was in New York or on telephone from San Francisco, I cannot remember, the question whether, if the returns for '43 were filed with the tax loss as a deduction, the amounts that had been accrued on the books, maintained by the agent for the trustees, the company's books here, should be reversed. And if [1379] so, what accounting treatment should be given of the possible liability, if the deductions were subsequently disallowed by the Treasury Department. Now I can't place the time of those discussions, except that it was in either December or January—December of '43 or January of 1944.

Q. To the best of your recollection, with whom did you have those discussions?

A. So far as I recollect, with Mr. Polk. There may have been discussions with Mr. Elsey, but I don't recollect them.

Q. Now did you participate in the decision to recommend the setting up of a contingent reserve fund for the federal taxes for the year 1943?

A. Yes.

Q. In what capacity did you participate in that discussion?

A. Mr. Elsey submitted to the reorganization committee, through me, his desire to put on the

(Testimony of Robert E. Coulson.)

books a reserve or a fund to protect possible liability if the Treasury Department denied that deduction. I took it up with Mr. Ecker and Mr. Wright, to the best of my recollection, and secured approval of Mr. Elsey's recommendation.

Q. When, if you recall, did you first learn of the type of federal tax returns which were to be recommended for the year 1944?

A. To the best of my recollection, it was late in the year 1944 that I first learned of it. I can't fix the time unless there is [1380] correspondence that shows.

Q. Who made the recommendation, if you recall?

A. It was Mr. Polk's determination to give that advice.

Q. Now when did you learn that a claim for refund of the taxes paid in 1942 had been or would be filed?

A. Again I cannot fix the time, but I think I learned of it at or about the time the claim for refund was filed.

Q. Now in the record here it appears that a stockholders' action which we call the "Van Kirk Action," was instituted in New York along at the end of June, 1946. When did you learn of the commencement of that litigation?

A. Shortly after it was started, because I was served as a defendant, with the company.

Q. Did you then believe that there was any con-

(Testimony of Robert E. Coulson.)

flict in your firm's representation of the affiliated group in the tax matter?

Mr. Phleger: Just a moment—well, I will withdraw that.

The Witness: I saw no conflict arising as a result of that litigation, no.

Q. And what is the basis of the answer you have just given?

Mr. Phleger: Now, I object to that on the ground it is incompetent, irrelevant and immaterial.

The Court: Well, you let him answer the question as to his belief. I suppose on the theory that that is a separate fact. Now you are asking to argue the matter and give his reasons why he felt that way about it. [1381]

Mr. Phleger: That is right.

Mr. Adams: That is a fair statement, your Honor.

The Court: Well, wouldn't that, of course, be subject to the orthodox objection that it is his opinion and conclusion?

Mr. Adams: Well, this is the party to the transaction; his firm were representing the trustees in the tax matter. There is some complaint about how the tax matters were handled in this case. I confess I don't get either the point or the significance of it; but I have heard some such complaint voiced. I have heard a generalization that this was taken over. I don't thoroughly understand what is meant by that. I am seeking to meet it, because that is

(Testimony of Robert E. Coulson.)

brought to us. This is a party to the transaction, your Honor, and I am asking about his action and about his understanding of his position at the time.

The Court: Well, you ask him to give his reasons for it. He can tell you almost anything he wants to as to that.

Mr. Adams: Well, I dare say we all expect answers from witnesses to be correct to the best of their ability.

The Court: Yes, but we are so often disappointed that we have these rules of evidence to prevent that.

I think the objection is good. I will sustain it. It just puzzled me a little bit why Mr. Phleger didn't object to the first one and did object to the second one.

Mr. Phleger: I just wanted to assist in the expedition of the case. I didn't think he would ask the second question. [1382]

Mr. Adams: I am very grateful to counsel for his cooperation.

Q. When did you first learn of the plaintiff's decision to bring this action now pending?

A. Mr. Polk told me about it at the time he had an exchange of correspondence, which I think was put in the record this morning, as to whether it would interfere with his tax work. And I think I had also been told by Mr. Osborn or Mr. Wood or Mr. Curry at or about that time, that it was proposed.

(Testimony of Robert E. Coulson.)

Q. Now you referred in your answer to correspondence that was put in this morning, and I will hand to you Defendant's Exhibit 37A, being a letter from the president of the corporation addressed to your firm, of September 27, 1946, and Defendant's 8A—no, 37B, being a letter from Mr. Curry to Mr. Nicodemus and Mr. Osborn of October 5, 1946, and 37C, being a copy of Mr. Polk's letter to Mr. Curry of October 4, 1946, the preceding day, and I will ask you if that is the correspondence and those are the letters to which you referred in your previous answer (handing to witness).

The Court: You are referring to Plaintiff's Exhibits or Defendant's Exhibits?

Mr. Adams: Defendant's, your Honor.

A. Well, the only letters I saw, Mr. Adams, were of course Plaintiff's Exhibit 8B and the exhibit, Defendant's Exhibit 37A, or Plaintiff's Exhibit 7, I guess it is here. I did not see Mr. [1383] Curry's letter to Mr. Nicodemus, and Mr. Osborn, which is 8A, Plaintiff's Exhibit 8A.

Q. I should not have shown it to you, obviously.

The Court: Now we have got the record all mixed up.

Mr. Adams: Yes, and so that the record may be all clear, because I have been confused and referring to some other marks instead of the ones here—the document Defendant's Exhibit 37A carries a deposition mark, Plaintiff's Exhibit 7. But

(Testimony of Robert E. Coulson.)

it is Defendant's Exhibit 37B—also marked Plaintiff's Exhibit 8A on deposition. And Defendant's 37C is also marked Plaintiff's 8B on deposition.

The Court: All right.

Q. (By Mr. Adams): Now referring to the time when you learned of plaintiff's decision to bring an action out here in San Francisco with regard to the tax matters here in issue, did you then believe that there was any conflict in the firm's representation of the affiliated group? A. No.

Mr. Phleger: Well, I will object to the question now upon the ground it calls for the conclusion of the witness, incompetent, irrelevant and immaterial.

The Court: Well, I think so. What have you got in mind there? He heard that they were going to be sued, and whether or not when he heard they were being sued, what was his belief as to whether the firm had acted in any improper manner? Is that [1384] involved?

Mr. Adams: No, the question is, your Honor, at that time the firm and Mr. Polk, the active man in charge, was handling these tax matters for this group before the government. This litigation came in New York, and the witness has said he personally was a defendant in it. He was a party to that litigation, in which were involved claims against the tax results of Mr. Polk's work, when, as, and if Mr. Polk's work should bring about tax results.

The Court: I understand that; but all you were asking him is what his belief was.

(Testimony of Robert E. Coulson.)

Mr. Adams: That is correct.

The Court: But he must have believed, giving him the benefit of all possible doubts, that we give everyone, he must have believed it was all right and then he went ahead and did it.

Mr. Adams: Precisely, your Honor. That is right.

The Court: What is the point of asking that of the witness then?

Mr. Adams: Well, I think we can assume that would be the answer, but that is the answer I expected from the question I asked.

Your Honor has ruled? I wasn't quite sure of it.

The Court: Well, I don't see the competency of it. I will sustain the objection. I know he is not going to say "No." He is not going to give the wrong answer, so don't worry about it. [1385]

Mr. Adams: Well, let me say this: I am sure that both the witness and his counsel will very firmly persist in the view that there was no conflict and that what was done was right. But that is a matter of argument.

The Court: I think so.

Q. (By Mr. Adams): Now, Mr. Coulson, did any representative of the plaintiff corporation inform you that he believed there was any conflict between the tax work that was being done for the affiliated group by your firm and Mr. Polk in particular, and your relations to the litigation, either in New York or here in San Francisco, in which

(Testimony of Robert E. Coulson.)

there were conflicting claims about the tax savings?

Mr. Clark: I object to that, your Honor, on the ground it is incompetent, irrelevant and immaterial. That is one of the allegations or burdens of the New York action, in which this gentleman was named as a defendant, part by the minority stockholders on behalf of the corporation.

The Court: Well, I think in this question it is pretty long, but in the beginning it started out with asking if anyone had made any on behalf of the corporation, had pointed that out to him; isn't that right?

Mr. Adams: That is right.

The Court: I think that may be proper. Overruled.

A. No one did.

Q. (By Mr. Adams): Now when did you first learn of the filing [1386] of the complaint in intervention in this litigation here in San Francisco before his Honor?

A. I can't fix the time, but to the best of my recollection, I learned of the complaint in intervention shortly after it was filed. [1386A]

Mr. Levy: Mr. Adams, Mr. Coulson's affidavit in opposition is dated March 21, 1946, if that would help you.

Mr. Clark: And it is in this record.

Mr. Adams: The record undoubtedly will show those dates.

Q. Had you any discussion with anyone con-

(Testimony of Robert E. Coulson.)

cerning settlement of the tax claim with the Treasury Department prior to February 11, 1947?

A. No.

Q. When did you first learn of the proposal of settlement?

A. When Mr. Polk called up from Washington when I was here in San Francisco, which to the best of my recollection was February 11.

Q. You recall the occasion?

A. I recall the occasion.

Q. Would you tell his Honor briefly the conversation that Mr. Polk had with you on that subject.

A. Mr. Polk called up from Washington and said that he had a discussion, a formal hearing before the Treasury Department officials there, that it looked as if the alternative was either to try out the issue of worthlessness before the tax court and the courts or to have some settlement of those issues satisfactory to the Government and to the taxpayer. He asked me to go to Mr. Elsey's office and discuss the matter with Mr. Elsey and advise him whether Mr. Elsey and his company would approve an offer of settlement to be submitted then [1387] on an informal basis, which would involve accepting the returns as filed, which meant an agreement by implication if the thing went through to give up any claim for refund as to 1942.

I did go to Mr. Elsey's office. Mr. Elsey did communicate with all the directors that could be

(Testimony of Robert E. Coulson.)

reached, except one that was away, or maybe two, and Mr. Polk was advised from Mr. Elsey's office that he was authorized to submit the settlement and a telegram and letter was sent to him at that time, as I recollect.

Q. Was anything said at that time about notifying or not notifying the plaintiff corporation?

A. I have no recollection of anyone mentioning it at that time.

Q. Did you ever at any time tell Mr. Polk that he was not to notify the plaintiff of the proposal of settlement? A. No.

Q. Mr. Coulson, do you recall that Mr. Curry was retained by your firm at the time of the closing of the New York office of the corporation and the trustees—actually then of the reorganized railroad company—along early in 1945?

A. Well, it was at or about the closing of the New York office.

Q. Mr. Coulson, I show you Plaintiff's Exhibit 32-A in this case. This is your signature, is it not?

A. It looks like a photostat of a letter which I signed, judging from the signature. May I look at the letter? This [1388] letter of April 21, 1945, addressed to Mr. Charles Elsey, was a letter which I recollect writing and signing at about that time.

Q. Prior to that time, Mr. Coulson, had you discussed the proposed retainer of Mr. Curry with anyone, to the best of your recollection?

A. Yes.

(Testimony of Robert E. Coulson.)

Q. With whom had you discussed the matter?

A. To the best of my recollection it was the subject matter of several discussions with Mr. Schumacher, Thomas M. Schumacher, who had been the chief executive in the New York office for many years. It was also, as I recollect, discussed with Mr. Osborn more briefly. It was discussed with Mr. Curry, and I think also with Mr. Nicodemus.

Q. And as regards Mr. Nicodemus, is your recollection clear one way or the other?

A. I am not sure. I recollect quite clearly and definitely the discussions with Mr. Schumacher and with Mr. Curry, because those discussions covered not only Mr. Curry's retainer but the other members of the staff in the New York office. Those I am quite clear on. And they were extended. I am quite clear I had some discussions with Mr. Osborn and I think some with Mr. Nicodemus, but I can't be positive as to that.

Q. Referring to the discussions on the subject of Mr. Curry's prospective retainer, will you please state to the best of your [1389] recollection the substance of the discussions you had on that subject before the retainer was effected?

A. Mr. Schumacher had discussed the problem at some length on the basis of the application of the company's retirement plan, not giving Mr. Curry a pension, which bore, as Mr. Schumacher saw it, a reasonable relation to the salary which Mr. Curry had been receiving as an executive in the New York office.

(Testimony of Robert E. Coulson.)

I want to add one more to the people I discussed it with, because before I wrote that letter to Mr. Elsey which you showed me, I took up the matter by telephone with Mr. Polk, who was away from New York, as to whether the suggestion that had been made in my talks, that Mr. Curry would be useful in connection with the consolidated return, was in his judgment well founded. Mr. Polk told me on the telephone, as I recollect it, that he thought Mr. Curry's usefulness would be substantial if these consolidated years of 1942, 1943 and 1944 came to trial, especially on depreciation matters and historical matters as to earlier years. It was on that basis that I then wrote Mr. Elsey suggesting that he be put on the stand by retainer in an amount about equal to the pension he would get from the operating company, and which brought his total overall compensation for the period while the tax matter was in process up somewhat more closely to his prior salary as an executive in the New York office [1390]

Q. Was there some discussion at or about the same time with regard to the other employees who had been in the New York office?

A. They were all discussed, both with Mr. Schumacher and with Mr. Curry.

Q. Please state to the Court briefly about that discussion and what was done as respects such employees.

(Testimony of Robert E. Coulson.)

A. Well, the employees in the New York office, other than Mr. Schumacher and Mr. Curry, who were the executives, and who were under the pension plan, were given by the railroad company a separation allowance of, to the best of my recollection, six months' salary. Some of them did not want immediate employment for one reason or another. There were two who wanted to go on working, and those two were employed by our office at that time and were referred to in that letter you showed me which I wrote to Mr. Elsey, although they were not a problem of the operating company except in the sense that the operating company was interested in knowing what happened to the New York employees after the closing of the office.

Q. And two of those employees came over to your office and you took them in?

A. Miss Valouch and Miss O'Neill came, and they are both still there.

Q. What services did you tell Mr. Curry he was to perform for his retainer when you made that arrangement with him? [1391]

A. I explained what we had in mind, that he would be available to assist Mr. Polk and would probably be used as a witness if those cases came to trial, and meanwhile he was to have a standby attitude of helpfulness to Mr. Polk in the preparation of material to assert the claims in the Treasury Department.

Q. I show you Plaintiff's Exhibit 33, being

(Testimony of Robert E. Coulson.)

a letter addressed to Mr. Curry of June 6, 1945, and ask whether that is the letter which you sent to Mr. Curry at that date stating the terms and outlining the services in respect to his retainer.

A. This letter accompanied the first quarterly payment of his retainer. It was not intended to outline his services which had been covered in conversations. It merely stated to him that the check was transmitted and that he was in the status of an independent contractor, so no deductions were being made for Social Security taxes or other deductions which would have been made had he been an employee of our office in the strict sense.

Q. How many times did you see Mr. Curry after he was retained by your firm?

A. I can't fix the number of times. It was not very often.

Q. Did you give him any instructions as to what he should or should not do?

A. Only the initial request that he put himself at Mr. Polk's disposal in connection with the consolidated return.

Q. Prior to the commencement of the VanKirk litigation in [1392] New York had you ever heard of a claim with respect to taxes in the nature of the claim set forth by the plaintiffs in that lawsuit?

Mr. Phleger: I object to that question on the ground it calls for the conclusion of the witness, irrelevant, incompetent and immaterial.

The Court: I suppose Mr. Adams means prior

(Testimony of Robert E. Coulson.)

to that time had anyone asserted that claim to his knowledge.

Mr. Phleger: That is not the question.

Mr. Adams: I did ask, your Honor, if the witness had ever heard of any such claim.

The Court: You mean any such claim being made against whom?

Mr. Adams: Any claim like this one.

Mr. Clark: Against anybody.

Mr. Adams: That is right. I did ask that question.

Mr. Clark: We join in the objection.

Mr. Adams: I have stated in argument from time to time that one of our contentions is that this is an afterthought claim, and this is the same sort of question that I have asked prior witnesses.

The Court: I think what counsel is bothered about, is this the same kind of question that you asked Mr. Polk?

Mr. Adams: I do not think it is, your Honor.

The Court: You are referring to the claim against the [1393] defendant in this case, are you not?

Mr. Adams: No, not at all. I am asking this witness, just as I asked Mr. Ehrman, Mr. Elsey and Mr. Osborn, if they had ever heard of a claim to be paid for the tax benefit of your loss when you are a loss company in a consolidated return. I did ask all those gentlemen that question, in view of my argument that this is an afterthought.

(Testimony of Robert E. Coulson.)

Mr. Clark: It is the same question that has been ruled on, your Honor.

The Court: I think it is objectionable. I do not see that it has anything to do with the question of its being an afterthought.

Mr. Adams: Do I understand that the objection is sustained?

The Court: Yes.

Q. (By Mr. Adams): Prior to the commencement of the Van Kirk action, Mr. Coulson, had you ever heard of the claim there asserted in behalf of the plaintiff corporation?

Mr. Phleger: I submit that has been asked and answered.

Mr. Adams: I would like to ask it again.

The Court: Read the question.

(Question read.)

The Court: You said that was the first time you had heard about it.

The Witness: No one had suggested it before, I think my [1394] prior testimony was, Judge. I can't bring it back word for word.

Q. (By Mr. Adams): Prior to the Van Kirk action had it ever occurred to you that the plaintiff had any such claim as was asserted in its behalf in the Van Kirk lawsuit?

A. Definitely—

Mr. Phleger: I submit the same objection that was made to substantially the same question some time ago. It is incompetent, irrelevant and im-

(Testimony of Robert E. Coulson.)

material and calls for the conclusion of the witness.

The Court: Sustained.

Mr. Clark: May the answer go out?

The Court: Yes.

Mr. Adams: I have no further questions, your Honor.

Mr. Phleger: I have no questions.

Mr. Clark: Nothing from us.

* * *

JAMES L. COCKBURN, JR.

called on behalf of the defendants; sworn.

The Clerk: Will you state your name to the Court, please.

The Witness: My name is James L. Cockburn,
C-o-c-k-b-u-r-n, Jr. [1395]

Direct Examination

By Mr. Adams: -

Q. And, Mr. Cockburn, will you please state your business and your business address.

A. I am with Price, Waterhouse & Company, certified public accountants, at 351 California Street, San Francisco.

Q. And you are forty-five years of age?

A. That is correct.

Q. You came to the United States in 1922 from Scotland and became a citizen in 1930?

A. That is correct.

Q. And your profession is?

(Testimony of James L. Cockburn, Jr.)

A. Certified public accountant.

Q. Please state briefly your education.

A. I went to primary and high school in Edinburgh Royal High School, in Edinburgh, Scotland. I was one year at the Heriot-Watt College in Edinburgh, an engineering course, and after coming to this country, in Honolulu, I attended classes in the evenings at the University of Hawaii, and the YMCA in accounting courses, and upon coming to San Francisco in 1926, I continued with my studies, including evening courses at Pace & Pace, San Francisco. This led to my sitting in an examination and getting my certified public accountant certificate in 1930, in California.

Q. Now, will you state briefly what professional experience you have had? [1396]

A. Well, I have been in public accounting, accounting and tax work, for approximately twenty-five years, starting with Young, Lamberton & Pearson in Honolulu in 1923, Price and Waterhouse from 1926 to the present time, except for a period of about three years, of which two and a half were spent as an assistant to the Comptroller of the California Packing Corporation in San Francisco and a few months in independent practice.

Q. Now, from about 1934, what part of your work would you say had been, had had to do, primarily, with tax work?

A. From 1934 on to 1943, I worked almost entirely in the tax department of Price, Waterhouse

(Testimony of James L. Cockburn, Jr.)
and I was in charge of the tax department from 1937 to 1943.

Q. And since that time have you continued to engage largely in tax work?

A. Both tax work and regular auditing work.

Q. Are you at the present time a member of the faculty of the Golden Gate College in San Francisco? A. I am.

Q. And what course are you giving there?

A. Auditing of revenue accounts.

Q. Auditing of revenue accounts. And you were admitted to practice before the United States Treasury Department in 1935?

A. That is correct. [1397]

Q. And you were admitted in the same year to practice before the United States Board of Tax Appeals, now the United States Tax Court?

A. I was.

Q. Of what professional—rather, let me put it this way: Would you please state briefly your activities, if any, in professional societies.

A. Well, I am a member of the American Institute of Accountants; I became a member of that organization in 1936. I have been a member of the California Society of Certified Public Accountants since 1930. I was a member of the Committee on Taxation of the State Society at various times, and was chairman about 1945-46 here. I was president of the San Francisco chapter of the California Society in 1947, and I have been a member of various committees in the society and chapter.

Mr. Adams: Now, at this time, your Honor, I

(Testimony of James L. Cockburn, Jr.)
would ask to have marked for identification as Defendants' Exhibit 40 a printed report entitled "The Western Pacific Railroad Corporation and Subsidiaries' Report on Federal Income Taxes Paid for the Years 1918 to 1944 and Settlements Amongst Companies in Respect Thereto," over the name of Price & Waterhouse Company, 351 California Street, San Francisco 4.

(The report referred to was marked Defendants' Exhibit 40 for Identification.)

Mr. Adams: And if I may take the liberty, I will hand up [1398] a copy to his Honor and state that copies of this report were furnished to counsel sometime prior to the pre-trial.

(Document handed to Court.)

Q. (By Mr. Adams): Now, Mr. Cockburn, did our firm request you to make an examination of the files and records of the Western Pacific Railroad Corporation and its affiliated companies for the period beginning in 1916 and ending April 30, 1944? A. It did.

Q. And would you state, please, the objectives of the examination which was requested?

A. We were asked to undertake three things: One, to determine the Federal and excess profits taxes paid by the Western Pacific Railroad Corporation and its subsidiaries for the period 1916 to 1944; secondly, we were asked to determine the settlements that were made between companies

(Testimony of James L. Cockburn, Jr.)

within the group, within the affiliated group, with respect to the Federal taxes on income; and, thirdly, we were asked to determine whether any company included in the consolidated return having a net income made a payment to a company with a net loss by reason of the fact that that net loss was included in the consolidated return.

Q. And did you make such an examination?

A. I did.

Q. Who made it?

A. It was made by me, assisted by several individuals in our [1399] San Francisco and New York office.

Q. And the assistants of whom you speak proceed with their work under your supervision and direction? A. That is correct.

Q. Would you please identify the persons who assisted you in your examination.

A. Mr. Richard Brown, Mr. Harold Erb, Mr. Frank Turk, and my principal assistant was Mr. Edwin H. Morse of San Francisco. Mr. Turk and Mr. Erb are in our New York offices.

Q. And would you also state what relation, if any, Mr. Morse has had to Price, Waterhouse & Company?

A. Mr. Morse has been with Price, Waterhouse & Company since 1939, except that he was originally with our New York office, and has been with us since that time except for a period of time in the armed services, with the Department of Audits, Washington.

(Testimony of James L. Cockburn, Jr.)

Q. And with which office of Price, Waterhouse & Company is Mr. Brown connected?

A. San Francisco.

Q. Was all the work in this examination done by you or under your personal direction?

A. It was.

Q. About how long a period of time was occupied in your work of examination and the completion of your report?

A. We commenced the work in May, 1948, and completed it early in January, 1949. [1400]

Q. Has your report been delivered to the Western Pacific Railroad Company? A. It has.

Q. Now, I hand you, Mr. Cockburn, the report now marked Defendants' Exhibit 40 for Identification (handing to witness). Is that a copy of the report? A. It is.

Q. Will you please describe briefly the records which you examined?

A. We first visited the office of the Western Pacific Railroad Company in San Francisco and there examined copies of Federal income tax and excess profits tax returns, Revenue Agents' reports and other material in the Federal income tax files. We examined the general books of account, including the general ledger, cash book, general journal, voucher register. We also inspected canceled checks and correspondence.

Q. And in addition to that, did you do some work with respect to the Western Realty Company records or accounts?

(Testimony of James L. Cockburn, Jr.)

A. We inspected similar records of the Western Realty Company at its office in San Francisco.

Q. Did you do any of your examination in New York? A. Yes.

Q. What did you do there?

A. We proceeded to New York and examined there similar records of the Western Pacific Railroad Corporation, and also their [1401] corporate minutes.

Q. Now, did you obtain any additional information from other sources beyond what you have already described? A. Yes.

Q. What was that?

A. We obtained additional information from the Treasury Department at Washington, D. C., consisting of certificates of over-assessment relating to certain years, and we also obtained certain additional information from the Utah Fuel Company.

Q. And where did you get that information?

A. At Salt Lake City.

Q. Now, Mr. Cockburn, what procedure did you follow in determining your findings?

A. Well, we made an analysis of the accounts relating to the tax expenses and receivable and payable accounts. With respect also to all of the companies in the Western Pacific group.

Q. And are your findings summarized in your report? A. They are.

Q. Now, in what manner, if at all, did you check your findings?

(Testimony of James L. Cockburn, Jr.)

A. We were able to check the taxes paid according to the expense accounts with the tax returns, Revenue Agents' reports and similar data. We were also able to check the tax paid by the various companies against the surplus reconciliation appearing in the tax return. Thirdly, we were able to cross-check the payments made between companies as between the books [1402] of the inter-company transactions and in particular letters concerning the transactions between the San Francisco and New York offices.

Q. So that you did in fact check entries both in San Francisco and corresponding entries and records in New York?

A. That is correct.

Q. In making such cross-checks did you find any discrepancies? A. We did not.

Q. Are your findings with regard to the subject matter of your examination correctly summarized in your printed report?

A. They are.

Q. Does your printed report correctly summarize the information contained in the tax records of the respective corporations for the period and on the subjects covered by your report?

A. It does.

Q. Do you believe it to be correct?

A. I do.

Q. Now, Mr. Cockburn, I will ask you to explain to the Court the schedules and tabulations it contains. Will you please first take Schedule 1.

(Testimony of James L. Cockburn, Jr.)

Mr. Phleger: May it please the Court, I think this is probably an appropriate time to interpose an objection to the admissibility of this identified exhibit and the material which it contains. The objection is that it is incompetent, irrelevant [1403] and immaterial. I think we have argued and discussed this matter at length heretofore. It is our position that what was done in the years previous to the critical years under different circumstances and under different law is no evidence in the case.

Mr. Clark: In addition to that, your Honor, so far as this document is concerned, it also contains conclusions as to matters of fact which are not subject to expert testimony, such as a statement in the first page to the effect that it was the consistent practice of the Western Pacific group to do this and that. It is also based upon certain assertions of fact which should properly be elicited by oral testimony. We will add to our objection that this is not a proper method of developing any expert opinion this gentleman may have.

Mr. Phleger: Our objection hasn't anything to do with that. Our objection is it is just incompetent, irrelevant and immaterial because the circumstances which existed during this entire period were entirely different from those which existed in these critical years, and the law was different.

Mr. Adams: May I respond to plaintiff's objection, because I think the interveners' objections are premature, the report not yet having been offered.

(Testimony of James L. Cockburn, Jr.)

Mr. Clark: We are simply adding them at this time to plaintiff's objection, in which we concur.

Mr. Adams: The objections are wholly premature as stated [1404] by the intervenor since I have not offered the report. The objections may run to the report when it is offered, but plaintiff's objection runs to the whole subject matter of this report and should, I think, fairly be answered at this time.

Your Honor, this is our defense. You will recall we had some discussion of this when Mr. Elsey was on the stand. One of our defenses is this, that during the whole period of affiliation between the plaintiff corporation and the defendant railroad company and other companies in that group, which began in 1916, and which ended for tax purposes on April 30, 1944, a consistent procedure was followed in the allocation of taxes, and that consistent procedure was that taxes should be allocated to the income-producing members of the group, and that no payment should be made to the loss company for the tax advantage which its loss brought to the affiliated group. That is our defense, your Honor, offered on our theory of the defense, on the particular facts in this case. We contend that that procedure, which this report is offered to establish, is binding upon the plaintiff corporation, being the party responsible and which established it. We contend further that it establishes a practice or contract relationship which will govern the determination of this case.

(Testimony of James L. Cockburn, Jr.)

We say further—and this is an additional reason for bringing forward this evidence—that when the plaintiff corporation comes into equity, and having enjoyed the advantages [1405] of an arrangement under which it secured the tax advantages of the losses of other companies and did not pay for them, it does not come into equity on the basis that equity can respond to, because of the ordinary rule that one who has had the fat off an arrangement between interlocking companies cannot then, when the thing turned out to be advantageous to someone else at the end of the period, insist upon taking a different position than that which he himself established and enforced during the time the arrangement was advantageous to him. These are theories. We have argued them before. And, as I say, this is our defense that we are putting in, and I take it your Honor can, of course, receive the evidence and consider its materiality in relation to any judgment your Honor may pronounce, but it would be inappropriate to exclude at this time evidence going to show the facts that are stated in the report. [1406]

The Court: I suppose there is really no dispute as to the fact because it all appears from the income tax returns and books that this was what was done, that is, what is shown in the report was done?

Mr. Adams: I think that is correct. This has been a very thorough and very arduous job to get the facts. We have had Mr. Cockburn and his associates, those who assisted him in his determination, spending months in getting the facts and

(Testimony of James L. Cockburn, Jr.)

getting them on a basis so that we think we have given a full, complete and correct account with respect to this matter for over all these years.

The Court: Of course, the only ultimate fact that is of any consequence is that each year the taxes were allocated as described in the report, and no credit or allowance was made to a company which suffered a loss in the group, or having contributed that loss, as it were, for the benefit of the final tax liability of the parent company or the group as a whole. I suppose there is no doubt about that.

Mr. Clark: Yes, there is, your Honor.

Mr. Adams: There are details provided in the report. If it is in, then counsel can use it. I rather assume that there is not going to be much question about the complete accuracy of the report. Then all counsel will have it to use as a basis of arguments, but we feel it is incumbent upon us—and we pleaded this in our pleadings—and we think it is a matter of defense [1407] that this was the continuous, standard practice that was followed throughout these years during all the time that the plaintiff corporation was the controlling party.

The Court: I would be inclined to think that as between the same parties to a transaction, that might be a persuasive argument. But, of course, you have the legal question here of whether this reorganized company can have the benefit of that. That, I think, would be one of the important questions that you have to present.

(Testimony of James L. Cockburn, Jr.)

Mr. Adams: I understand that is the plaintiff's theory of the case. We have a view that where the plaintiff starts during the period when it is in command and control and takes advantages out of the arrangement which it establishes, and then when, at the end of a tax period an advantage comes to another member of the affiliated group, the plaintiff should not be heard to complain of the advantage of the other member if under its own practice established by itself it took the advantage in prior years and neither recognized any claim nor heard any complaint from any other member of the group that the plaintiff was doing what the plaintiff now complains of here.

The Court: I think those are matters that you will have to argue on the submission of the case. I still think the main question in this case is the question of the right, if any, in the plaintiff and the admeasurement of that right. There is no conflict that the reorganized company got the benefit of this. [1408] It may be that you can show that the plaintiff had no right or had no right that is capable of monetary measurement. I do not know. That is the real question in the case. I do not think any of these other matters make any difference.

Mr. Adams: We offer it as a part of our defense, your Honor, and you will appreciate it if I were to take a very simple situation—let us say you and I have been engaged in some kind of a common enterprise, and at the beginning of the term the arrangement between us has been very satisfactory

(Testimony of James L. Cockburn, Jr.)

to me. I do not think then at the end of the term, because it turns out to be very satisfactory to you, that I am in a position to complain about that.

The Court: As I say, if it is the same parties, of course, there might be a good argument, but your opponents contend that some new owners here got the benefit of this and they still think they have a right to get some salvage out of it because these other fellows got a benefit. I do not know if they have such a right. My mind is open on that, or whether it is capable of admission. That is a problem you gentlemen will have to labor under.

Mr. Adams: I am just seeking to put in my defense so I will have my facts, so that when the time comes for argument we will have them to argue from.

The Court: I merely suggested, counsel, that there is not much point in spending a lot of time arguing about the [1409] admissibility of this at this time. Why not let the witness testify that everything in this report is correct, and if you are not satisfied with his statement in that regard, you can cross-examine him on that. If you do not wish to cross-examine him, let the record be admitted in evidence and the question whether it has a legal bearing upon the issues of this case you can argue at the time of the submission of the case.

Mr. Phleger: We think we should interpose our objection so as to preserve our position. Counsel, I am sure, inadvertently, misstates the situation.

(Testimony of James L. Cockburn, Jr.)

We were the parent company during this period, and as the tax laws contemplated and intended, of course, we got the benefit. That did not require allocation of losses back and forth at all, but when we became a complete stranger, with no further financial stock in the situation, why, what took place in prior years is utterly immaterial.

The Court: I understand the position of the parties in the matter, but the defendant wants to assert a defense which he says he cannot present unless he has some record to present it on, because if he just says he is presenting it on the basis of the past conduct of the parties, he hasn't anything in the record to show what that was. He has no factual basis upon which to predicate that defense, and I think it probably would be a waste of time now to argue this thing out, because when you get all through I think I would take refuge in the rule of civil procedure which would allow me to reserve ruling on it, because I would want to [1410] consider it. I would want to have the benefit of the arguments of both sides on it, and I think the most sensible thing to do, and which would save time for everyone concerned, so that the whole question could be presented with its various facets at one time, would be simply to make your pro forma showing and have the witness testify that everything in that report is true and correct as a result of his investigations, and I will admit it in evidence subject to the future determination upon the sub-

(Testimony of James L. Cockburn, Jr.)

mission of the case as to whether or not it has a material bearing and does sustain the legal defense which is urged, and then you can argue that out at the time of the submission of the case. It certainly is unnecessary for me to sit here and listen to this witness go into each schedule and tell how he did it, if you are not going to raise any question about that.

Is that procedure generally agreeable to all counsel?

Mr. Phleger: That is entirely satisfactory.

Mr. Adams: I will ask the question asked by your Honor:

Q. Based upon the examination you have described, does your credit report correctly summarize the information contained in the books and records of the respective corporations for the period and on the subject covered by the report?

A. It does.

Q. And you believe it to be in all respects true and correct to the best of your capacity?

A. I do. [1411]

Mr. Adams: I will offer Defendant's Exhibit 40 for identification now as Defendant's Exhibit 40 in evidence.

Mr. Clark: To which we object, your Honor, on the ground stated by Mr. Phleger for the record, and also we specifically object to the inclusion of the first two pages, that is, the narrative on the first two pages of the offer as being conclusions on factual matters which should not be considered

(Testimony of James L. Cockburn, Jr.)

as evidence in the case. Other than that we have no objection to the suggestion of the court as to how they should be treated.

The Court: I won't give any weight to the opinion of the witness in that regard, inasmuch as it is a factual report. And I will admit it subject to the conditions which the court has already stated. However, if after examining the report either the plaintiff or the intervener wishes to conduct any cross-examination of the witness in respect to the accuracy of any statement, that right should be reserved to both the plaintiff and the intervener.

Mr. Clark: Very well, your Honor.

Mr. Adams: The record will show, your Honor, that counsel for all the parties have had copies of this report since some time prior to the pre-trial in this case.

Mr. Phleger: That is right.

Mr. Clark: That is right. [1412]

* * *

(The Defendant's Exhibit No. 40 for identification was thereupon received in evidence.)

Mr. Adams: If the Court please, I ask that there be marked for identification as Defendant's Exhibit 41 for identification a single sheet dated February 16, 1949, entitled "The Western Pacific Railroad Company, Federal Income and Excess Profits Taxes for Years 1942 and 1943 and for the First Four Months of 1944," on the basis of assuming that the Western Pacific Railroad Company had filed sepa-

(Testimony of James L. Cockburn, Jr.)

rate returns and had the benefit of its own net operating loss carry-overs and excess profits credit carry-overs computed as though it had filed separate returns in prior years, and the additional deductions from income as shown in the note below, and ask that the document be marked for identification Defendant's 41. And if I may take the liberty, I will hand up a copy to the Court, copy having been furnished this day to opposing counsel.

The Court: This would be similiar, then, to Plaintiff's Exhibit 73?

Mr. Adams: Basis 2. [1413]

The Court: Is that Basis 2?

Mr. Adams: Yes, Basis 2. It is more or less similar to Basis 2, but there is quite a wide difference, your Honor.

The Court: I mean you are attempting to show the same general thing?

Mr. Adams: I will ask the witness about that.

The Court: Very well.

Q. (By Mr. Adams): Mr. Cockburn, I hand you Defendant's Exhibit 41 for identification. Is that paper a summary of computations which you made?

A. It is.

Q. Where did you obtain the basic information from which your computations were made?

A. From the tax returns filed.

Q. And the tax returns for what years?

A. For the years 1939 to 1944, inclusive.

Mr. Adams: Now may the record show that the

(Testimony of James L. Cockburn, Jr.)
returns for 1940 to '45 have already been offered
by the plaintiff?

Q. And do you have a copy of the 1939 tax re-
turn here? A. Yes.

Q. May I refer to that?

Mr. Adams: I will ask that Mr. Morse hand
it up.

Mr. Phleger: The return for 1945 is not in evi-
dence and we would like to have it in evidence, and
also that for '46 and '47. [1414]

Mr. Adams: Well, my recollection was that Mr.
Buchanan testified with regard to the basis of his
computations, that he had used the returns from
1940 to 1946. Am I correct in that?

Mr. Phleger: Mr. Buchanan?

Mr. Clark: No, it is not.

Mr. Phleger: 1944.

Mr. Clark: In the last eight months, I think
he said, of '44.

Q. (By Mr. Adams): Oh, that is in, yes. Well,
your Honor, I don't have the returns for '46 and
'47 with me, but with counsel's permission, I may
proceed with the examination on the calculations,
and we can produce the basic returns when we re-
sume at the next session, if that is agreeable.

I do, at this time, offer as Defendant's Exhibit
42, the corporation income and excess profits tax
return of the Western Pacific Railroad Corpora-
tion for the year 1939.

The Court: Well, why do you need that in con-
nection with this?

(Testimony of James L. Cockburn, Jr.)

Mr. Adams: The witness testified he had to go back to the figures in that return in order to get his computations.

The Court: For Exhibit 41?

Mr. Adams: Yes, your Honor.

The Court: I see.

The Clerk: Are you offering that in evidence?

Mr. Adams: Yes. And may I state I am producing this from [1415] the files of the defendant railroad company, being a copy sent by the plaintiff corporation to the defendant railroad company of the consolidated returns for 1939.

(Whereupon income tax return for 1939 was received in evidence and marked Defendant's Exhibit 42.)

Q. (By Mr. Adams): Now, Mr. Cockburn, referring to Defendant's 41 for identification, the schedule in your hands, did you make any correction in the information appearing on the income tax returns you have described in making the computations on this schedule?

A. Yes, I have made two principal corrections: one, the information from which these corrections were made appears in revenue agent's report dated June 12, 1947, relating to an examination of 1940 and 1941 consolidated federal income tax returns. The first adjustment related to a loss claimed on abandonment of Deep Creek properties, and the second related to an amount of reorganization expense of \$169,000, that was disallowed.

(Testimony of James L. Cockburn, Jr.)

Q. Now his Honor inquired how it came about that the income tax return for 1939 was related in any way to these computations. Did that arise in connection with the Deep Creek loss?

A. Part of it, yes.

Q. Well, please tell his Honor that part, and the other part as well.

Q. The Deep Creek loss was originally reported in 1940 federal [1416] income tax return. The revenue agent in his report explained that it was a 1939 item, and we therefore repositioned the loss to 1939; and as a result of a difference in the law, the item, the greater portion of the item, or \$600,000 for which the loss was claimed in 1940, was considered to be a capital loss, and since the company had already availed itself of a \$2,000 capital loss reduction, no benefit was obtained by repositioning the loss into that year. The balance of the adjustment of reorganization expense was just not claimed as a deduction in 1940.

Q. Go right ahead. I didn't want to interrupt you.

A. To explain further, the reason it was necessary to take into consideration the 1939 figures, the 1939 loss is a carry-over into the year 1941, for a net operating loss deduction, and in turn, that affects the excess profits credit carry-over into subsequent years.

Q. Was the consequence of this correction which you made to increase or to decrease the tax liability computations on 41 for identification?

(Testimony of James L. Cockburn, Jr.)

A. It increased the computation, the tax.

Q. Now in your computations, Defendant's 41 for identification, what treatment did you give inter-company interest accruals?

A. We treated that interest as a deduction.

Q. Had those inter-company interest accruals been eliminated in computing the consolidated return tax liability? [1417] A. They had.

Q. Is it your understanding that they may be properly restored as deductions in computing income on a separate return basis? A. It is.

Q. And do you have an understanding with respect to the recognition of such interest accruals where they have occurred during reorganization proceedings?

A. Yes, and the Commissioner has ruled on that.

Q. To what ruling do you refer?

A. I believe it is X.T. 3635.

Q. Now in the consolidated returns which were actually filed, were deductions taken for accruals of interest on all Western Pacific Railroad obligations that were held outside the affiliated group?

A. They were.

Q. Is it your understanding that such interest is deductible, even though not taken up as income in the accounts or tax returns of the creditors?

A. It is.

Q. Did you make any deductions not appearing on the consolidated returns as filed in the computations in your exhibit 41 for identification?

A. I did.

(Testimony of James L. Cockburn, Jr.)

Q. Will you please state what they were?

A. We made deductions for accelerated amortization in the years [1418] 1942, in the amount of \$127,531.24; in 1943, in the amount of \$259,654.81; in the first four months of 1944, in the amount of \$522,741.10. I also made deductions for the United States Government freight cut-backs and refunds in 1941 of \$50,000; in 1942, \$780,000; in 1943, \$1,060,000; the first four months of 1944, \$40,000. I also made a deduction for a partial bad debt loss on the Sacramento Northern Railway notes and advances in 1943, in the amount of \$8,526,690.72.

Q. Now, Mr. Cockburn, referring to the amounts you have stated, of deductions on account of accelerated amortization, will you please state the basis of deductions taken for accelerated amortization?

The Court: Well, the witness has answered that question. May I make this inquiry, so I can get myself a little bit oriented to this? I may be in error in this, but is the difference a substantial difference between Mr. Buchanan's basis and this estimate, the items that are listed at the bottom of the page of this Exhibit 41? I mean, a big, substantial difference?

Mr. Adams: Your Honor, your Honor's inquiry is based on, of course, at first, the proposition that the deductions that are taken in the lower half of this exhibit were not taken in Mr. Buchanan's Basis 2.

(Testimony of James L. Cockburn, Jr.)

The Court: Well, of course. I say that is the reason why this basis in Exhibit 41 is so much lower than that which this witness has included, or in which this witness has included, the [1419] substantial items that Mr. Buchanan did not use in his basis. I am not asking you to commit yourself, I just wanted to find out if, substantially, that is the basis of the difference between the two estimates.

Mr. Adams: Well, I would like to ask Mr. Cockburn one question to help me in giving your Honor my answer.

Q. Leaving out of account the effect of deductions, Mr. Cockburn, the three deductions that are taken account of in this schedule, have you made any figure to determine the variance or approximate variance between the computations you have made and the computations which Mr. Buchanan made on his Basis 2 of Plaintiff's Exhibit 80?

A. No.

Mr. Adams: Well, perhaps we can bring that to your Honor in the morning. We can give you a figure that would more accurately answer your Honor's question.

The Court: Well, it just kind of looks like it to me, and that is why I asked the question, because I see there is about \$10,000,000 and if you add that to \$7,000,000—well, you get pretty close to it. There must be some other figures involved in it, but it looks to me as if that might be the substantial difference.

Mr. Adams: The witness has stated he has taken

(Testimony of James L. Cockburn, Jr.)

account of some inter-company interest deductions that Mr. Buchanan did not take account of, and some other factors. [1420]

The Court: There might be some other factors.

Mr. Adams: I think your Honor is right.

The Court: It seems to me the bigger amount by way of difference are these figures.

Mr. Adams: I believe that is true; and furthermore, I believe that Mr. Buchanan gave some figures on accelerated amortization that somewhat resemble the figures that are produced on this exhibit. So that the larger deductions are the latter two in effect. Mr. Buchanan said himself that he hadn't taken off accelerated amortization in producing his Basis 2 figures, but he gave us some figures when we talked with him about it.

Mr. Phleger: I don't like to interrupt, but would it not be helpful if this witness, in the morning, could give us the figures without these adjustments?

Mr. Adams: Well, it is a little quick work; these things don't get done in five minutes.

Mr. Phleger: In other words, if he gave us the figures without the adjustments, then you would have the comparable figures for Basis 2.

The Court: Well, maybe you can calculate that.

Mr. Adams: Let me suggest this: Mr. Cockburn and Mr. Buchanan have been discussing this matter one with the other.

Q. Have you not? A. That is correct.

Mr. Adams: I think Mr. Buchanan can produce

(Testimony of James L. Cockburn, Jr.)

the figures [1421] for Mr. Phleger that the plaintiff desires.

The Court: I only asked the question because it would seem to me that the thing could centralize on these figures here that you are examining him about. That will create the real issue as between the two estimates.

Mr. Phleger: That is correct.

Mr. Adams: Well, I think in addition to that we can produce a figure of our own—or at least I hope so. If we have any substantial variance with Mr. Buchanan's figures, on his own hypothesis, that is.

The Court: I think that would be helpful, Mr. Adams.

Q. (By Mr. Adams): Now, Mr. Cockburn, referring—wait a moment, didn't I have an open question, your Honor, and then your Honor asked a question?

The Court: Yes, you asked him the basis of these figures on accelerated amortization, and then is when I interrupted you. There is where there was some question like that asked by you, I seem to recollect.

Mr. Adams: That is what it was about, yes, your Honor.

Q. Would you state the basis of the deductions taken here for accelerated amortization? When I say "taken here," I mean on 41 for identification

A. Under the provisions of the Internal Revenue laws, a taxpayer which had constructed an emer-

(Testimony of James L. Cockburn, Jr.)

gency facility for war purposes was permitted to amortize the cost of the facility over [1422] a 60-month period, with provision in the law that if the war ended earlier, and by proclamation of president, they would then have the election of amortizing the cost of the facility over the period from the date the facility was completed to within a certain period of time after the date of proclamation, or to take the balance of the amortization over the normal life of the asset involved.

The Court: Was 1942 the first year, then, that that could be availed of?

The Witness: That was the first year in which, your Honor, the Western Pacific Railroad Company had any assets constructed under these provisions of the law. I am not sure whether it began, or actually could have started in 1941 or '42, if they had facilities in an earlier year.

Q. (By Mr. Adams): Now, Mr. Cockburn, referring to the deductions as indicated on 41 for identification, during the four years, 1941, 1942, 1943, and the first four months of 1944, for United States Government freight cut-backs, refunds, will you please state the deductions you have taken in your computations for those freight cut-backs and refunds? [1423]

Mr. Phleger: Now excuse me for interrupting; I am trying to be helpful. Are you dropping the amortization claim now? Because in our view, the witness has not supported at all his deductions. He

(Testimony of James L. Cockburn, Jr.)

has stated what the law is, but he hasn't stated what the facts are.

Mr. Adams: Well, my recollection is that Mr. Buchanan, the witness, came out about the same with these figures. I am not dropping it at all; I don't have any query in my mind about it. What is your question as to amortization?

Mr. Phleger: Well, I would say before any foundation was laid, for any such deduction, you would have to show how much the emergency facilities were that were constructed, and when they were constructed, the years in which they were taken, how he readjusted them, and what the tax credits by this readjustment were that the company received that should have been offset by these additional amounts.

Mr. Adams: Can you answer Mr. Phleger's question?

A. The first portion of his question I might answer by stating that the information from which these figures were computed appears in the tax returns which were filed. The portion of the amortization, the facilities, are listed in the schedule attached to the return, and the computation of the accelerated portion of that amortization, which is listed here, was determined from the information appearing there. [1424]

Mr. Phleger: Yes, but not in returns that are in evidence.

Mr. Adams: If your Honor please, I didn't surrender the witness altogether.

(Testimony of James L. Cockburn, Jr.)

Mr. Phleger: No, but I wanted to be helpful. I will not ask any further questions. I will have to object to this exhibit on the acceleration matter, because there is no proper foundation. The information that he refers to in our later returns—

The Court: Well, he will have to develop that inquiry first.

Mr. Adams: The witness has been interrupted, I thought, in his answer, and I would like to have him continue with his answer.

Mr. Phleger: Excuse me.

A. (Continuing): These computations were made by us from the information appearing in the returns for the years '42, '43 and '44, and we assumed in making these computations that the taxpayer, the Western Pacific Railroad Company, would have elected to claim the benefit of accelerated amortization if it had been to its benefit to do so.

Q. (By Mr. Adams): Now, making that assumption, did you find in the returns as filed the figures from which you were able to compute the deduction for account of accelerated amortization, if that election were exercised? [1425]

A. I did.

Q. Those figures you found in the returns as filed? A. That is correct.

Q. Were they all that you required as an accountant, a tax accountant, to satisfactorily compute that deduction? A. That is correct.

Q. Now, then, may I turn to the item of deduction for the United States Government freight cut-

(Testimony of James L. Cockburn, Jr.)

backs and refunds; and I will ask you to explain that deduction appearing for the four years I mentioned.

A. The figures from which these deductions were computed were obtained from the general auditor's office of the Western Pacific Railroad Company, and a sum was obtained, an approximate total freight cut-back of \$2,000,000 for the period '42 to '46.

Q. Now, then, what method did you use in determining the particular amounts of the deductions applied to '41, '42, '43 and the first four months of '44, out of that total of \$2,000,000?

A. These are based on the actual figures obtained from the general auditor's office and rounded out to the nearest \$10,000.

Q. So that you obtained actual figures for each of the particular periods which are indicated here, each of the particular years, and part of the year, which are indicated here on 41 for Identification?

A. That is correct.

Mr. Phleger: Do I understand that these figures were given to the witness or that he got them out of the files?

The Witness: They were given to us.

Mr. Phleger: Then I move that that matter be stricken out as hearsay.

Mr. Adams: Well, your Honor, it is just a question of connecting up. I am putting in a computation at this time, and I assume that with an objection of this sort, it will be necessary for me to

(Testimony of James L. Cockburn, Jr.)

produce the witness who has taken two months to make the particular computation on this calculation, on which this calculation is predicated.

The Court: Yes. Well, subject to its not being connected up you can, of course, move to strike it out.

Q. (By Mr. Adams): Now, Mr. Cockburn, will you please explain the deduction of some \$8,500,000 in 1943 on account of the partial bad debt loss on Sacramento Northern Railway notes and advances?

A. On December 31, 1943, Sacramento Northern Railway Company, a wholly owned subsidiary of Western Pacific Railroad Company, owed to the Western Pacific Railroad Company on unsecured notes and open account advances the amount of \$9,474,100.80. Mr. Elsey has informed us that in his opinion these notes and advances were worth only 10 per cent of face at that time.

Q. That is in what year? [1427]

A. In the year 1943.

Q. Now, could a deduction have been taken on account of a part of that indebtedness in 1943?

A. It could.

Mr. Phleger: Just a moment. I move that that be stricken out on the ground that it is a conclusion of the witness. And no proper foundation laid, a legal matter.

Mr. Adams: Well, we don't expect to bind his Honor as to any legal matter, but certainly the man who made the computations should be in a

(Testimony of James L. Cockburn, Jr.)

position to explain it, and that is the purpose of these questions.

Mr. Phleger: Well, that is an entirely different matter. He is acting upon a certain assumption.

The Court: Well, of course this is just a computation. I don't think that the witness is offering to testify in order to prove that that is a proper deduction.

Mr. Adams: Certainly not, your Honor.

Mr. Phleger: That was the question that was asked him, namely, could this deduction be taken in that year.

The Court: Well, that depends upon the facts as to whether that would be a proper deduction.

Mr. Adams: Of course, your Honor. But the witness knows something about this, and I think he should state from his point of view as an expert accountant the basis on which a deduction, speaking as an expert accountant, could have been [1428] taken in a return for that year. It wouldn't be binding on your Honor, nor on any party, but it will explain how the witness makes the deduction, and it is for that purpose that I ask the question.

Mr. Phleger: Now, there is pending a motion to strike out the previous question and answer. The witness was asked whether or not this could be deducted in that year. He said "Yes," and I moved that it go out.

The Court: Yes, I think that motion is good. You can ask the witness to give the reasons why he included it in his computation.

(Testimony of James L. Cockburn, Jr.)

Mr. Adams: Thank you, your Honor. He may do that.

The Court: That, of course, wouldn't be a statement that it was deductible in that year.

Mr. Phleger: No, because this is a legal question, not an accounting question.

The Court: That is right. I think there is no doubt about that.

Q. (By Mr. Adams): Would you state the reasons, Mr. Cockburn, why you included this item in your calculations, including the same deduction in your calculations on 41 for Identification?

Under the provisions of Section 23(k) of the Internal Revenue Code, a taxpayer is permitted to claim a deduction for a debt which is partially worthless, and may claim that portion of the debt down to the point to which it is worthless, [1429] and which is written off in the year in which it is deducted.

Mr. Phleger: Now may it please the Court, that is a legal answer. He is quoting the law.

Mr. Adams: He is stating his understanding.

Mr. Phleger: We don't agree that the law justifies this deduction.

Mr. Adams: Well, your Honor, we shall never contend—

The Court: That is the reason he put in this tabulation. That is the effect of the testimony. I will allow it for that purpose. That doesn't prove that it is a proper deduction.

(Testimony of James L. Cockburn, Jr.)

Mr. Adams: Surely.

The Court: It merely indicates the reason on the part of the man who made the tabulation for including it.

Mr. Adams: We shall always contend the witness is an excellent tax accountant, but any question of law is for the Court.

Q. Now, Mr. Cockburn, upon what hypotheses or assumptions did you include this particular deduction in the computations in Defendants' Exhibit 41?

A. Upon the assumption, first, that it was worth only 10 per cent of face on December 31, 1943; secondly, that it had been written down by a 90 per cent amount in the accounts for that year; and, thirdly, that no deduction had been claimed for this amount in prior years, and allowed.

Q. And did you also assume, as I think you stated in your [1430] schedule, that the railroad company filed a separate return for that year?

A. The railroad company was included in a consolidated return for the year 1943.

Q. Yes. I am asking you upon what assumptions you included this deduction in your computations. That is No. 41 for Identification.

The Court: He has already said that this is a schedule that refers to the filing of a separate return for these years by the committee. What this amounts to is if it is a good deduction, why, then, it could be taken. That is all.

(Testimony of James L. Cockburn, Jr.)

Mr. Adams: Yes, your Honor.

The Court: And that if it were taken, this would be the result of the calculation.

Mr. Adams: I perhaps could just get one question on this, and finish with this particular exhibit.

The Court: Very well.

Q. (By Mr. Adams): In your opinion, Mr. Cockburn, do the computations you have made on Defendants' Exhibit 41 for Identification state correctly the tax liability of the Western Pacific Railroad Company for Federal income and excess profits taxes for the years 1942 and 1943, and the first four months of 1944, on the basis of the assumptions that are described in the computation, and to which you referred in your testimony?

A. They do. [1431]

Mr. Phleger: Well, just a moment. I will object to that. He stated what he did. Now, some of the assumptions are on this document. There are some other assumptions that are in his testimony, and I am sure we are going to find there are a lot of other assumptions. I think this should rest, that this is a computation made on the basis that he has testified to, and that the accuracy of the figures on that basis, that he believes the figures are accurate on that basis, not that the tax liability is as shown.

Mr. Clark: The question calls for his testimony that this is a correct tax liability upon this.

Mr. Adams: Oh, on the basis of the assumptions that were included in my question, your Honor, it

(Testimony of James L. Cockburn, Jr.)

is a computation of tax liability on the basis of the various assumptions that are indicated.

The Court: I don't see any objection to that. I will overrule the objection.

Mr. Adams: And I will offer the document, then, now, as Defendants' Exhibit 41.

Mr. Phleger: Well, now, I—

Mr. Adams: Subject to being connected up.

Mr. Phleger: I don't think the foundation has been laid at all for these assumptions.

The Court: Well, I think all this amounts to is that having these, without any question as to the validity of the [1432] various deductions that are taken, that if they were taken, the calculations would be as stated in this.

Mr. Phleger: Well, that is all right.

The Court: Well, that is the way I understand the testimony.

Mr. Clark: Or if they could be taken.

Mr. Phleger: In other words, if they could have been taken upon the basis stated, that this is the tax that he figures out would have been paid.

The Court: Well, I think that is what Mr. Adams had in mind.

Mr. Adams: That is right, your Honor, and I understand further that it will be obligatory on my part to connect up, by another witness, the cut-back and refund figures that are shown here on this exhibit.

Q. It is a fact, is it not, Mr. Cockburn, that the figure for the Sacramento Northern Railway notes

(Testimony of James L. Cockburn, Jr.)

and advances is 90 per cent of the amount of these notes and advances as of the end of the year 1943?

A. That is correct.

(Defendants' Exhibit 41 for Identification was received in evidence.)

Mr. Adams: I have no further questions this afternoon, your Honor. If it is an appropriate time to recess?

Mr. Phleger: Before adjournment, do I understand, Mr. [1433] Adams, that this witness will have the figure as to what the computation would be without the deductions down below?

Mr. Adams: I don't think so. I think you can get it easily from Mr. Buchanan. I think this witness will be very busy, but we will do the best we can. But why don't you try Mr. Buchanan?

Mr. Phleger: Well, after all, these are his figures (indicating).

Mr. Adams: No, you were asking for a comparison with Mr. Buchanan's figures.

Mr. Phleger: I am not asking for a comparison, I am asking what figures this witness would show without the deductions.

The Court: Can you figure that?

The Witness: No, we have not figured that.

The Court: You didn't make any calculation leaving out these items of amortization and cut-backs for the Sacramento Northern? That is, you didn't make any calculation leaving out those figures

(Testimony of James L. Cockburn, Jr.)

as to what the tax would be if a separate return was filed? Or did you?

The Witness: We have made quite a number of computations, your Honor, and I couldn't be too certain. I don't think we have. That takes a little while; it would be a different set of computations, and a different net operating loss carry-over, excess profit credits and other elements entering into the computations. They are very involved computations. [1434]

The Court: That may be so.

Mr. Phleger: Then there will be no estimate on this basis if these assumptions are not correct or any of them. [1435]

* * *

JAMES L. COCKBURN, JR.

resumed.

Direct Examination (Continued)

By Mr. Adams:

Q. Mr. Cockburn, since yesterday's session have you made a rough computation of the amount of tax liability which the Western Pacific Railroad Company would have incurred on the various assumptions contained in Defendants' Exhibit No. 41, exclusive of the deductions that are described in note 1 to that schedule? A. I have.

Q. What is the amount?

A. Approximately \$14,800,000.

Q. I would like to call your attention to the

(Testimony of James L. Cockburn, Jr.)
computation described as Basis 2 in Plaintiff's Exhibit No. 80. Do you have a copy of it?

A. I have.

Q. That computation shows a total tax liability of approximately \$15,572,000 for the Western Pacific Railroad Company for the same period on the assumptions stated in that document?

A. That is correct. [1437]

Q. I direct your attention to the fact that the difference between that figure and the one you have just given is about \$771,000, and I will ask you if you will tell the Court briefly the principal factors accounting for that difference.

A. The principal factors are the deductions claimed by us in our computations for interest on inter-company holdings of indebtedness, the re-positioning of the Deep Creek loss from 1940 to 1939, the elimination as a deduction in 1940 of reorganization expenses, the changes required in the computation of the net operating loss, and reversing excess profits credit carry-overs, result in a difference in our bases; and also other minor inaccuracies which are not material to the computations and which can probably be corrected.

Mr. Adams: At this time, your Honor, I offer for identification a schedule dated February 16, 1949, marked C, consisting of one page entitled "Western Pacific Railroad Company Federal Income and Excess Profits Taxes for Years 1942 and 1943 and the First Four Months of 1944," on the basis of assuming that the Western Pacific Railroad

(Testimony of James L. Cockburn, Jr.)

Company had filed separate returns and had the benefit of its own net operating loss carry-overs and excess profit carry-overs, computed as though it had filed separate returns in prior years, and the additional deductions from income as shown in the note below.

I believe that will be 43 for Identification.

(The document referred to was marked Defendants' Exhibit 43 [1438] for Identification.)

Mr. Adams: May I ask that a copy be handed up to his Honor.

Q. Mr. Cockburn, do you have a copy of that schedule C in your hands? A. I do.

Q. You also have a copy in your hands of Schedule D, which is now Defendants' Exhibit 41?

A. I do.

Q. Will you please explain to the Court the difference between Schedule D introduced yesterday as Defendants' Exhibit 41 and this Schedule C, which you have in your hands.

A. The computations in Schedule C are based on exactly the same figures as used in Schedule D, with the exception of the amount deducted for United States Government freight cut-backs and refunds. Those in Schedule D were on the basis of a total of approximately \$3,000,000 for the period 1942 to 1946, and on Schedule C on the basis of \$3,000,000.

Mr. Adams: Will you read the answer?

(Answer read.)

(Testimony of James L. Cockburn, Jr.)

The Witness: I wish to correct that answer. The computations in Schedule D were on the basis of \$2,000,000 for the period for United States Government freight cut-backs and refunds, and the computations in Schedule C are on the basis of \$3,000,000 for the same deductions. [1439]

Q. (By Mr. Adams): That is the only difference between Schedule D, which is Exhibit 41, and this Schedule C in your hands?

A. That is correct.

The Court: That is about \$370,000?

The Witness: That is correct, your Honor.

Q. (By Mr. Adams): And so that your testimony yesterday, stating the bases, and assumptions on which you prepared Schedule D would apply likewise to this schedule with that one difference?

A. Yes, it would.

Mr. Adams: I will offer the schedule previously marked 43 for Identification as Defendants' Exhibit 43.

Mr. Phleger: I object to the receipt upon the ground that it is incompetent, irrelevant and immaterial and also upon the basis that the assumptions shown to have been made with respect to this item are contrary to the evidence in the record.

The Court: Well, I admitted the other exhibit merely as a computation, not as proof of the validity of any of the deductions claimed therein—but only as a computation assuming the validity of the deductions, that the tax would be so much.

(Testimony of James L. Cockburn, Jr.)

Mr. Phleger: Yes. I think that the assumptions, or some of the assumptions, are contrary to the evidence in the record. If I can simply have my objection noted, I have no—

The Court: Well, I take it, Mr. Phleger, that Mr. Adams is perhaps putting this on, shall we say, a little bit out of [1440] order, as he may be intending to put in some other kind of evidence to sustain the validity of these deductions which are asserted in this return, or to make some legal showing on that.

Mr. Adams: I would like to respond to your Honor on that. With regard to the deductions for accelerated amortization, we consider they have been proved. With regard to the deduction for partial bad debt loss on the Sacramento Northern Railway notes and advances, we consider we have offered all of the proof, and our own proof is that that deduction is based upon the hypothesis that the partial loss was written into the books in 1943, which it was not, in fact. So that this is a hypothetical approach on a separate tax return basis. With regard to the United States Government freight cut-backs and refunds, the third item of deduction in this computation, I stated yesterday to your Honor that I would have to connect up the \$2,000,000 figure, Mr. Elsey having spoken about that as the actual figure, but having gotten his information from his auditing department. So I will have the witness here to testify to that actual \$2,000,000 figure.

(Testimony of James L. Cockburn, Jr.)

Now, this Exhibit C carries that deduction on the \$3,000,000 basis. Mr. Elsey testified to an estimate of an additional million dollars, and that is just why this is \$3,000,000 in this schedule whereas it was \$2,000,000 in the other schedule.

Mr. Phleger: But Mr. Elsey also testified that he was [1441] unable to allocate those statements to any year.

The Court: Well, of course, now we are getting into an argument as to the effect of the testimony with respect to these items. I see no harm in, subject to the limitations stated, allowing the computations in; so that if it appears that there is validity to the deductions, the Court will have before it a calculation showing the amounts involved. If it appears that there isn't validity to these deductions, then the schedules will be of no importance in the matter.

Mr. Clark: Well, may it be understood, your Honor, that they are admitted subject to motions to strike in the event they are not connected up?

The Court: I think perhaps that might be the best way of handling it, so with the statement that the Court has made, that these two exhibits—has 41 been admitted here?

Mr. Adams: Yes, your Honor.

The Court: So that 43 may be admitted on the same basis as 41 was admitted, plus the conditions that the Court has just included in admitting the statement in evidence.

(Testimony of James L. Cockburn, Jr.)

(Defendants' Exhibit 43 for Identification
was received in evidence.)

Mr. Adams: I take it the same understanding should apply to Plaintiff's 80, the computation the plaintiff has introduced?

Mr. Phleger: Oh, not at all. They were mathematical computations from the income taxes. [1442]

Mr. Adams: I am not arguing how good or bad they were, merely if there is to be an open proposition about a motion to strike as to our computations, we should, by parallel reasoning, have the same right.

The Court: Well, of course, on the face of the case it would involve the amount of taxes, both sides can argue as to the effectiveness of their computations with respect to taxes. I don't think we need to make any particular rulings on that at this time.

Mr. Adams: No. I just asked for parity of treatment.

The Court: It is very obvious what these schedules are for. One side says, "Now, if we win the case we have to show what the saving of income tax was. This is our calculation of what it was. It is based on certain factors." The other side says, "Well, even if you do win the case, it isn't as much as you say, because these other factors have to be taken into account."

Now, that is one of the issues the Court will have to determine, and the schedules merely assist the

(Testimony of James L. Cockburn, Jr.)

Court in fixing the amounts, depending upon which respective contention is established. That is all. Now, I think with what we have said, we understand one another, and each side's rights are protected in the record.

Mr. Adams: Now, if your Honor please, I offer for identification the single schedule sheet dated February 16, 1949, [1443] marked B, entitled "The Western Pacific Railroad Company Federal Income Taxes for 1942 and 1943 and the First Four Months of 1944, on the Basis of Assuming That the Western Pacific Railroad Company Had Filed Separate Returns and Had the Benefit of Its Own Net Operating Loss Carry-overs and Excess Profits Credit Carry-overs Computed as Though It Had Filed Separate Returns in Prior Years, and the Additional Deductions from Income as Shown in the Note Below," and I will ask that a copy be handed up to his Honor.

(Copy of document handed to Court.)

(The document referred to was marked Defendants' Exhibit 44 for Identification.)

Q. (By Mr. Adams): Mr. Cockburn, do you have a copy of the schedule B, now marked Defendant's 44 for Identification, in your hands?

A. Yes.

Q. Now, in this Defendants' 44 for Identification, at what figure is the deduction for United States Government freight cut-backs and refunds taken? A. \$2,000,000.

(Testimony of James L. Cockburn, Jr.)

Q. And then what difference is there between Defendants' 44 for Identification and Defendants' 41, the schedule introduced yesterday, in which the cut-backs were taken at the same figure?

A. You refer to Schedule D? [1444]

Q. Yes.

A. The difference between those two schedules is that in Schedule B, identified as B, we have deducted United States Government reparations as claims in the amounts indicated, and in the years indicated, based on total reparations claims of \$12,000,000.

Q. Now, the figures you have there on that matter are stated under the years 1942, 1943 and 1944. Can you explain what relation those figures bear to the \$12,000,000 figure which you assumed on account of the reparations claims?

A. We went to the company's office, and from certain records there obtained totals of the Western Pacific Railroad Company's United States Government freight for the years 1942 to 1946, inclusive. And we assumed that the \$12,000,000 should be prorated over the years in proportion to the amounts of United States Government freight in the years 1942 to 1946.

Q. And I take it you yourself do not take any responsibility for the \$12,000,000 figure which was supplied to you as an assumed figure over the whole period for the amount of reparations?

A. That is correct.

Q. And this, then, is a computation, this Sched-

(Testimony of James L. Cockburn, Jr.)

ule B, Defendants' 44 for Identification, which involves in addition to the hypotheses and assumptions on which 41 is based, the further assumption that deductions may be taken for reparations claims, and that such deductions would apply to the tax years in [1445] question; you have both of those assumptions, do you not, in respect of the deduction for the reparations claims in this schedule?

A. That is correct.

Mr. Adams: I offer the document, your Honor, as Defendants' Exhibit 44, and not as in any wise proof of the validity of that last deduction, but as the computation which will be made, assuming that any figure can be made for the amount of reparations claims. We know, of course, that at present that litigation between the Government and the carriers has not proceeded to a point upon which any definite figure can be ascertained.

Mr. Phleger: May it please the Court, I object to the admission of this proposed exhibit upon the ground it is irrelevant, incompetent, immaterial and no foundation has been laid for it. We had an extensive discussion, as you will recall, upon this matter and on our objection to the admission of this evidence, which was sustained.

Mr. Clark: Same objection.

Mr. Phleger: That is, claims predicated upon railroad reparations.

The Court: I think counsel is entitled to have in the record a calculation that would show what

(Testimony of James L. Cockburn, Jr.)

the situation would be if the evidence were proper. I see no objection to allowing it merely as a calculation. It is not offered in proof of [1446] any of the facts stated.

Mr. Phleger: Your Honor, in the course of the argument it was demonstrated that this is a reparation matter pending before the Interstate Commerce Commission, which all the railroads resist as being absolutely unfounded. It not only involves validity of claims, but it involves the amount of claims and it involves the assumptions that are made as to the spreading of the claims.

The Court: Mr. Phleger, I understand all of that, but counsel on the other side seems to think he should have a calculation in the record. It does not prove anything, and if there is no validity to the deduction, then the calculation does not mean anything. I see no harm in allowing it as a calculation subject to those conditions.

Mr. Clark: And subject to a motion to strike.

The Court: Subject to a motion to strike.

(Defendants' Exhibit 44 for Identification was received in evidence.)

Q. (By Mr. Adams): Mr. Cockburn, I ask you to turn for a moment to Defendants' Exhibit 43, the schedule marked C, and referring to the amounts shown there on Defendants' 43 for the freight cutbacks and refunds, please state what procedure you followed in calculating and computing those amounts for each of those years.

(Testimony of James L. Cockburn, Jr.)

A. The United States Government freight cut-backs and refunds [1447] on Schedule C are based on figures obtained from the general auditor's office and rounded out to the nearest \$10,000.

Q. Referring to the fact that on Schedule D, Defendants' 41, the figures for the same deduction are in each case lower, and in that Schedule 41 aggregate approximately \$2,000,000—do you bear that in mind? A. Yes.

Q. Is that correct?

A. I probably should explain that on Schedule C the figures are based on the figures obtained from the general auditor's office increased by 50 per cent.

Q. In other words, the method by which you got your cut-backs and refund figures in Defendants' 43, marked C, was to increase roughly by 50 per cent the figures that are shown for the same deduction in 41 marked D?

A. That is correct.

Mr. Adams: If your Honor please, I offer for identification as Defendants' 45 a schedule marked A, dated February 16, 1949, consisting of one page and containing a title similar to the title of the papers previously offered, that is, the Exhibits 41, 43 and 44. I hand up a copy to the Court.

(The document referred to was marked Defendants' Exhibit 45 for Identification.)

Q. (By Mr. Adams): Mr. Cockburn, referring to this schedule marked A, February 16, 1949, Defendants' 45 for Identification, [1448] will you

(Testimony of James L. Cockburn, Jr.)

please state to the Court what difference there is between that schedule and the schedule marked B, Defendant's 44?

A. The only difference between those two schedules is that in Schedule A the United States Government freight cut-backs and refunds are based on a \$3,000,000 figure, whereas in Schedule B they are on a \$2,000,000 figure.

Q. And otherwise the Schedule A is based on the same assumptions and hypotheses on which the Schedule B, Defendants' 44, was based?

A. That is correct.

Mr. Adams: I will offer the exhibit now marked Defendants' Exhibit 45 for Identification as Defendants' Exhibit 45. It does contain figures in addition for the reparations claim, as your Honor will note, and the statement, of course, that I just made applies with respect to that matter.

Mr. Phleger: May I note the same objection and reserve a motion to strike?

The Court: The exhibit will be admitted subject to the same objection, under the same conditions, and subject to the same motion to strike.

(Defendants' Exhibit 45 for Identification was received in evidence.)

Mr. Adams: If your Honor please, I offer as Defendants' Exhibit 46, and hand up a copy to the Court, for identification, [1449] a single sheet entitled "Western Pacific Railroad Corporation Federal Income Taxes for the Years 1922 to 1944

(Testimony of James L. Cockburn, Jr.)

Inclusive, on the Basis of Assuming That the Western Pacific Railroad Corporation Had Filed Separate Returns and Comparison Thereof With Taxes Allocated to That Company on the Basis of Consolidated Returns Filed Dated January 14, 1949."

(The document referred to was marked Defendants' Exhibit 46 for Identification.)

Q. (By Mr. Adams): Mr. Cockburn, do you have a copy of that schedule, Defendants' 46 for Identification, in your hands? A. I do.

Q. Now, have you computed the taxes which the Western Pacific Railroad Corporation would have paid during the period 1918 to 1944 if it had filed separate returns whenever permissible?

A. I have.

Q. And I have handed you this document, Defendants Exhibit 46 for Identification. Did you find that the corporation would have paid \$593,-976.33 more on a separate return basis than it actually did pay during the period on a consolidated return basis? A. I did.

Q. And that is the figure appearing at the bottom of the last column of this tabulation, Defendants' 46 for Identification? A. Yes.

Q. You believe that the tabulation is correct? A. I do.

Mr. Adams: I will offer the document, your Honor, as Defendants' Exhibit 46.

Mr. Phleger: I wish to object to its receipt upon the ground it is incompetent, irrelevant and imma-

(Testimony of James L. Cockburn, Jr.)

terial, just like all of the other previous records.

The Court: It goes to the weight of that phase of the testimony that counsel is offering. I will overrule the objection.

(Defendants' Exhibit 46 for Identification was received in evidence.)

Mr. Adams: I offer as Defendants' 47 for Identification a single sheet schedule dated February 15, 1949, entitled "Western Pacific Railroad Company Federal Income Taxes for the Years 1922 to 1941, Inclusive, on the Basis of Assuming That the Western Pacific Railroad Company Had Filed Separate Tax Returns and Comparison Thereof With Taxes Allocated to that Company on the Basis of Consolidated Returns Filed," and ask that this be marked Defendant's 47 for Identification, and I would ask that a copy be handed up to his Honor.

(The document referred to was marked Defendants' Exhibit 47 for Identification.)

Mr. Phleger: Have you copies of that?

Mr. Adams: Yes. I gave them to you yesterday.

Mr. Clark: We do not have a copy of that.

Mr. Adams: Yes; I handed three copies to counsel yesterday.

Mr. Levy: We have everything else, but not that.

Mr. Adams: I do not know what happened to them, because, of course, we were handing all these papers to you.

(Testimony of James L. Cockburn, Jr.)

Mr. Phleger: That is all right. We can get it later.

Mr. Adams: Would you like to come and look at it as I talk about it?

Mr. Phleger: We are going to object to it anyhow.

Q. (By Mr. Adams): Mr. Cockburn, have you computed the taxes which the Western Pacific Company would have paid during the period 1922 to 1941, inclusive, if it had filed separate returns whenever permissible during that period?

A. I have.

Q. Did you find that the Western Pacific Railroad Company would have paid during that period \$408,869.51 more on a separate return basis than it actually did pay during this period on a consolidated return basis? A. I did.

Q. That is the figure appearing in this tabulation at the bottom of the column?

A. That is correct.

Q. You believe it is correct? A. I do.

Mr. Adams: I will offer this document as Defendants' 47, and as your Honor will see, we are really proving a converse [1452] here for the benefit of our adversaries.

The Court: You are showing the advantage of a consolidated return.

Mr. Adams: Both ways, and the net advantage to the plaintiff corporation.

Mr. Phleger: We say there is only one advantage to the consolidated return and that is to the

(Testimony of James L. Cockburn, Jr.)

parent corporation. May I note the same objection?

The Court: Yes. The exhibit will be admitted under the same conditions.

Mr. Adams: I take it the plaintiff cannot have 47 without having 46. The two things are correlative, one with the other.

(Defendants' Exhibit 47 for Identification was received in evidence.)

Q. (By Mr. Adams): Mr. Cockburn, have you examined Plaintiff's Exhibit 80 in this case, consisting of computations of income taxes for the plaintiff corporation and its affiliates on three separate bases for the years 1942, 1943, and the first four months of 1944?

A. Do you refer there to Basis 1?

Q. I referred to all three bases, and asked you if you had examined Plaintiff's Exhibit 80, which consists of all three bases? A. I have. [1453]

Q. Do you have a copy of it in your hands?

A. I have.

Q. Would you look, please, at the first page of Plaintiff's Exhibit 80, in which is set forth the so-called Basis 1. Have you made an effort to check Basis 1? A. Yes.

Q. Do you agree that Basis 1 is a correct statement of what the tax liability of these companies would have been if they had filed separate returns for the period indicated, using data actually shown on the consolidated return without any change or

(Testimony of James L. Cockburn, Jr.)

adjustment? A. No, I do not.

Q. In what respect do you think that these computations on that assumption or hypothesis are incorrect?

A. These computations fail to claim a deduction for intercompany interest. The net operating loss carryovers are not included; excess profits—

The Court: This schedule is without the carryovers. There is a separate schedule in it that covers that.

Mr. Adams: That is right, your Honor. I take it the witness is commenting on certain matters that he thinks would necessarily be taken into consideration merely from taking the figures off the returns.

The Court: That is going to be confusing now, because there is a separate schedule on it. [1454]

Q. (By Mr. Adams): Mr. Cockburn, leaving out any reference to net operating loss carryovers and any reference to unused excess profits credit carryovers, you have stated, as I understand it, that the computations are incorrect in that the intercompany interest deductions were not restored.

A. That is correct.

Q. Is there any other correction, if you leave out those carryovers that I have mentioned, that you think should be made in the figures shown on the returns to correct the figures shown on Basis 1?

A. Net operating loss carrybacks within the period were not deducted.

Q. If the figures were corrected so as to take

(Testimony of James L. Cockburn, Jr.)

proper account of the two factors that you have mentioned, your restoration of the deductions and the allowance for carryback of net operating losses, do you believe that the figures would then show the amount of tax which those companies would have been required to pay for this period if they had filed separate instead of consolidated returns?

A. No.

Q. And why not?

Mr. Phleger: I object to that. This is merely an argument of some of the basic legal propositions involved in the case. He is not attacking the computation. He is saying this is not the way to determine what the tax saving is. On the same [1455] basis all of these last exhibits would have been rejected, it seems to me.

Mr. Adams: This is a computation. It states on its face what it is.

The Court: This computation, Mr. Cockburn, of Basis 1 would be correct in your opinion, would it, as a computation were it not for the fact that these interest payments that you refer to were not included? I am talking about it now as a computation. Forget about the argument that you make as to the validity of the deductions; just as a computation. The thing that is wrong with it as a computation is—what amount did you come to on that? Was it about \$300,000 of interest?

A. No.

Q. You mentioned some amount.

Mr. Adams: We gave a difference of—

(Testimony of James L. Cockburn, Jr.)

The Witness: \$770,000 approximately.

Mr. Adams: —of approximately \$770,000, but that was as to Basis 2, was it not, Mr. Cockburn?

The Witness: That is correct.

Mr. Adams: The Judge is asking about Basis 1.

The Court: Now, what I am trying to find out, and I think it will shorten this matter, is that you have before you a computation of one of your competitors here.

The Witness: That is correct.

The Court: And all we want to know, or all I want to know at this stage of the proceeding is, is that a correct calculation. I take it it would be correct as a calculation, were it not for the failure to include this interest item that you speak of. But as a calculation, and irrespective of the validity of the various deductions and the right to take them.

The Witness: There is one element I would like to explain there, your Honor, before I answer that categorically yes or no.

The Court: All right.

The Witness: The net operating loss deductions —strike that. No adjustment has been claimed for accelerated amortization, which the company might have elected to take.

Mr. Phleger: Well, that is not shown on the returns.

The Court: This is a calculation, as I recall the testimony, that was taken from information on the

(Testimony of James L. Cockburn, Jr.)

consolidated return. Now all we want to know is, as a calculation of the information on the consolidated return, is this a correct calculation? Forget about whether the deductions are right.

Mr. Adams: Now if your Honor please, may I suggest that your Honor's question carries within its content some different— [1457]

The Court: Well, I will get somebody myself to calculate it. It seems to me that what I am suggesting is a very simple matter.

Mr. Adams: Your Honor, I think it is, if the witness—

The Court: And if Basis No. 1 wasn't calculated correctly from the return, somebody can tell me that without going into the legal questions as to the validity of the various deductions involved. That is all it was offered for.

Mr. Adams: That is right. What I think is implicit in the witness' mind, and of course I don't know, but I am assuming this, is that when he is asked about the correctness of calculations he has in his mind that this Basis 1 assumes to be some kind of an approach to what the tax liability would have been on a hypothesis, and so really is different; that there are various computations which, in his view, should have been included in this which aren't made here.

Q. That is right, is it not, Mr. Cockburn?

A. That is correct.

Q. So that, to answer his Honor's question, you

(Testimony of James L. Cockburn, Jr.)

think, as far as the arithmetic goes, as far as this computation is concerned, you don't quarrel with the arithmetic but you point out certain deductions you mention which should be included, and that certain allowance for carry-backs were not included that you would include if you were to make a computation like that?

The Court: Well, of course that is obvious, and it was [1458] obvious from the testimony of Mr. Buchanan that those items were not included in his calculation.

Mr. Adams: And does that answer your Honor's question?

The Court: Am I right about that, Mr. Cockburn?

The Witness: The answer is "yes" to your question on that basis.

The Court: All right.

Mr. Phleger: Well, can't we get a figure? I don't want to interrupt, but can't we get Mr. Cockburn's check of the figure that appears on Basis 1 of—

The Court: He just said it is correct.

Mr. Phleger: Oh, it is correct. Oh.

The Court: Without it being admitted that these factors that he has in mind were not included.

Mr. Adams: But your Honor, we shall contend, of course, that is manifestly incorrect, because such consideration should be taken into account.

The Court: Well, I don't deprive you of that right. I understand that.

(Testimony of James L. Cockburn, Jr.)

Q. (By Mr. Adams): Now I would like to turn to Basis 2, Mr. Cockburn, in Plaintiff's Exhibit 80, and then turn to your schedule, Defendant's—no, not the schedule.

Bearing in mind that I asked you this morning if you had made a computation of the tax liability which would have been incurred on the various assumptions in our Exhibit 41, but [1459] excluding the deductions—you recall giving that testimony?

A. I do.

Q. And you recall that your brief computation of that amount came out at about \$14,800,000?

A. That is correct.

Q. And then—

The Court: That is about \$900,000 less than the Basis 2?

Mr. Adams: No, you see the Basis 2 that we are comparing our figure with is the one given for the Western Pacific Railroad Company, the first one on the righthand column.

Mr. Phleger: \$772,000.

Mr. Adams: No, \$15,726,000 if I read that rightly.

Mr. Phleger: No.

Mr. Adams: I beg your pardon, \$15,572,000.

Mr. Phleger: That is correct.

Mr. Adams: Yes.

Mr. Phleger: It is the top figure, your Honor, opposite the "Western Pacific Railroad Company," \$15,572,630, of Mr. Cockburn, or I mean, of Mr. Buchanan.

(Testimony of James L. Cockburn, Jr.)

The Court: I see.

Mr. Phleger: Against \$14,800,000 of the witness.

The Court: Besides a difference of about \$700,000.

The Witness: About \$770,000.

The Court: The difference between the result of Basis 2 and your Exhibit 41? [1460]

The Witness: That is correct.

Q. (By Mr. Adams): Now do you believe that Basis 2 makes proper allowance for the carry-overs?

A. No, I do not.

Q. Will you explain that, please?

The Court: You mean they haven't calculated the carry-overs correctly in this schedule?

The Witness: That is correct.

The Court: We will take a brief recess at this time.

(Recess.)

Q. (By Mr. Adams): Mr. Cockburn, I wish you would turn to the third page of Plaintiff's Exhibit 80, Basis 3. Have you examined that basis and checked it? A. I have.

Q. Do you think that the tax liability shown on Basis 3 are the amounts of the taxes which would have been payable on a consolidated return basis for the years '42 and '43 and the first four months of '44 if the stock loss of the Western Pacific Railroad Corporation had been disallowed in toto?

A. I do not.

Q. And would you please state what corrections

(Testimony of James L. Cockburn, Jr.)
should be made in order to arrive at a correct computation on that basis?

A. I would make adjustments for accelerated amortization, United States Government freight cut-backs, and refunds, and United States Government reparations claims. [1461]

Mr. Phleger: Well, now I object to that response and move that it go out.

The Court: I can't see the point of that answer at all.

Mr. Adams: Well, your Honor, the Basis 3, according to its own title, purports to be "Federal Income Taxes and Excess Profits Taxes on Basis of Consolidated Returns as Filed, but Excluding Corporation's Stock Loss."

The Court: Yes, but all Mr. Buchanan did was to take the stock loss out of it, and on the same information that was in the return, make this calculation. Now I don't think the witness is intending to say that on that basis, this basis is incorrect.

Mr. Adams: Well, I take it that the witness being an accountant, he is permitted to say what approach he would make to the same question that is indicated at the top.

The Court: Well, what you are asking him now to testify is that if he had filed the consolidated return for this corporation at the time it was filed, and he wasn't including the stock loss in it, that he would have included something else in it.

Mr. Adams: That is right.

(Testimony of James L. Cockburn, Jr.)

The Court: That is what you are asking him to say.

Mr. Phleger: Well, he is not even saying that, your Honor, because the reparations didn't occur until years later. Cut-backs, too. [1462]

Mr. Adams: It didn't occur to me that this answer could be objectionable, since it is an expert's statement of his differences, and that is all it is.

The Court: Yes, but this Basis 3 was offered in connection with testimony of Mr. Buchanan, only to show that the calculation of the taxes on the basis of the return as it was filed, if the stock loss would have been excluded, would have shown this result. Now that is all the witness testified to. That is all Mr. Buchanan testified to, according to my recollection.

Mr. Adams: Yes.

The Court: Now with that in mind, Mr. Cockburn, is there any inaccuracy in these figures as far as you know?

The Witness: Schedule 3, Basis 3—

Mr. Adams: Just a moment. Pardon me the interruption.

The Court: Well, all right, I will withdraw the question.

Mr. Adams: Well, I think I can put the question this way.

Q. Mr. Cockburn, you notice that Basis 3 carries a notation, "Corporation's excess profits credits for 1944 prorated." A. That is correct.

(Testimony of James L. Cockburn, Jr.)

Q. And is it your understanding—you discussed this with Mr. Buchanan—that that proration was on one-third of the corporation's excess profits credit for the year? A. That is correct.

Q. He used that in making his computation?

A. That is correct.

Q. Now if you assume that you are going to make the computations on Basis 3 and only give one-third of the corporation's excess profits credit for 1944, would you then find any error in the computations themselves?

A. Yes, I would.

Q. And what error would you find there?

A. I do not agree with the portion of the computation whereby two-thirds of the excess profits credit—

Q. No, Mr. Cockburn, you didn't understand my question. My question was, If you assume that you are making the computation on the basis of a one-third proration, then would you find that the computations themselves were inaccurate?

A. No, I would not.

Mr. Adams: That gets at what your Honor had in mind, I take it?

The Court: Yes.

Mr. Adams: And now at this time, your Honor, I would like to offer a chart. It is a reduced picture of the big picture that is over there on the side wall (indicating). It is a replica in smaller form and easier of reference. This chart is a chart

(Testimony of James L. Cockburn, Jr.)

that we, the counsel, prepared, like the charts over on the righthand side of the court room as I face your Honor (indicating). It is a pictorial representation, all of the figures in which and all of the data in which is taken from that [1464] exhibit you have in your hand, Defendant's Exhibit 40.

The Court: All right.

Mr. Adams: I offer this as Defendant's Exhibit—

The Court: As a pictorial representation?

Mr. Adams: Simply as a lawyer's representation of what is contained in the report.

But I should say one further word about it. In the report which your Honor has before you, Defendant's Exhibit 40, there is stated, particularly in note 2 to Schedule 1 to that report, a full statement with regard to a special transaction between the plaintiff corporation and the Utah Fuel Company. Your Honor will see there is quite an elaborate statement in note 2 about that. Now this chart does not take that special transaction into account in any way. It leaves it out.

I might explain, by way of further elucidation, why that is left out. Neither the Western Pacific Railroad Company nor any of its subsidiaries were participants in the special transaction between the plaintiff corporation and the Utah Fuel Company.

Mr. Clark: You will concede, though, Mr. Adams, won't you, that the Utah Fuel Company was a member, a subsidiary and member of the affili-

(Testimony of James L. Cockburn, Jr.)

ated group at that time, namely, up to the year 1924?

Mr. Adams: I make all the concessions which are stated in note 2 which includes the statement Mr. Clark just made. All the facts are fully stated in that report, and I expect both counsel can talk about them to the extent they want to. [1465]

With that explanation, your Honor, I offer this as a lawyer's chart for your Honor's convenience, and not as proving anything additional to what is proved in Defendant's Exhibit 40.

Mr. Phleger: As we objected to 40, I would like to record the same objection to this.

The Court: On the incompetency of the material itself?

Mr. Phleger: Right.

The Court: Well, I think we have sufficiently covered that ground, so that the record is clear. It may be marked.

(Chart referred to was then received in evidence and marked Defendant's Exhibit 48.)

Mr. Adams: No further questions, your Honor.

Cross-Examination

By Mr. Phleger:

Q. Mr. Cockburn, referring to your computations on Defendant's 41, as to what the tax would be eliminating the deductions as noted at the bottom, I understand your figures was \$14,800,000?

A. Is that Exhibit D? I do not have it.

(Testimony of James L. Cockburn, Jr.)

Q. D, yes. And I understand also that you have compared with Basis 2 of Plaintiff's 80, the figure, being \$15,572,630, on Basis 2?

A. That is correct.

Q. Now will you state exactly what the difference between your figure and Mr. Buchanan's figure is?

A. Well, we only made approximate computations, and computed [1466] that the approximate difference was \$14,800,000, and the figures I testified to were the computations of the liability of our Schedule D, but not claiming any of the deductions as stated in footnote 1.

Q. Then let me ask this question: Is Mr. Buchanan's computation, Basis 2, opposite the Western Pacific Railroad Company, \$15,572,630, incorrect as a matter of computation upon the basis on which he computed Basis 2?

Mr. Adams: Well, your Honor, is it clear what is meant when reference is made to the basis on which Mr. Buchanan computed?

Mr. Phleger: Yes, it is stated in the caption.

Mr. Adams: Well, that is just the point; I don't think the caption does state it. For example, Mr. Buchanan did not restore the inter-company interest deductions. He did so testify. I don't think the witness who is now on the stand was here at the time Mr. Buchanan so testified.

Mr. Phleger: I want to have a comparison, a real comparison, between Basis 2, according to Mr.

(Testimony of James L. Cockburn, Jr.)

Buchanan and his computation, and according to this witness' computation.

A. The basic differences between the two computations, without being able to give exact tax amounts caused by the different deduction amounts, the deductions for inter-company interest, is the repositioning of the Deep Creek loss from 1940 to 1939, the disallowance of deduction or not claiming a deduction of [1467] approximately \$169,000 for reorganization expense, which was claimed in the return for 1940—differences in the net operating loss carry-overs and excess profits credit carry-over as a result of the different assumptions, and certain minor differences, errors, in computations, which I think could be corrected.

Q. Well, other than for those changes which you have just recited, your figure would be approximately the same as Mr. Buchanan's figures?

A. That is correct.

Q. Now the computation on Defendant's 41 and on Plaintiff's Exhibit 80, Basis 2, is as a matter of fact, not in accordance with the regulations, is it?

Mr. Adams: Now just one moment; your Honor, if your Honor please, I object to the question. The question assumes something that is not stated in the question. Both those computations have been made upon the assumption of separate returns being filed.

Mr. Phleger: No, that isn't my point, Mr. Adams.

(Testimony of James L. Cockburn, Jr.)

Mr. Adams: It is my point in objecting to the question.

Mr. MacKinnon: I object to it upon the ground that it calls for the witness' expression on a question of law. That is for your Honor to decide.

Mr. Phleger: The purpose of my question, your Honor, was to point out that the exhibit prepared by this witness and introduced by the defendant assumes a fact that is contrary to existing [1468] law, namely, that you cannot, having filed consolidated returns in one period, file separate returns in a later period and use the carry-forwards and carry-backs, contrary to regulation 110, Section 33.31 (e) and (f). Isn't that correct?

Mr. Adams: Your Honor, I object to the question and I direct your Honor's attention to the caption of the schedule itself. And further I object on the ground the question asked is a question of law, the same objections having been addressed to my interrogation of this witness and sustained.

The Court: I think it is needless to pursue this particular line of inquiry as a matter of evidence. It is very obvious that your accountant is of the view, probably supported by some legal advice, that these carry-overs cannot properly be included, but nevertheless he has put them in anyhow and to make another basis of calculation, and the witness on the witness stand may or may not have the contrary view, but it is really of no importance because that question is a question of law, isn't it?

(Testimony of James L. Cockburn, Jr.)

Mr. Phleger: I think I have not made myself clear at all. What I am trying to point out to this witness—and the fact that I have not made it plain justifies the question—is that both this witness, in Defendant's Exhibit 41, and Mr. Buchanan in Basis 2, have both made the computation, although it is not permitted by the regulation which is cited as regulation 110, so that they are on the same basis. [1469]

The Court: Except that this witness may have a different view. He may say that it is permitted under that regulation. I do not know.

Mr. MacKinnon: If your Honor please, I do not think it makes any difference what he says because you are going to determine that question.

Mr. Phleger: I want to point out that the basis of the two exhibits is the same.

The Court: I think that is obvious without the witness' testimony.

Mr. Adams: With the variances between the figures which the witness has testified to.

Q. (By Mr. Phleger): Did you examine the books of the defendant corporation as to the manner in which its amortization claims were in fact handled?

A. Do you refer there to subsequent treatment of those claims?

Q. No, the actual way in which they were treated.

A. The treatment of the amortization is dis-

(Testimony of James L. Cockburn, Jr.)

closed in the returns which we inspected and from which we made our computation.

Q. So you did then examine the actual treatment made of the amortization claims as shown by the tax returns? A. That is correct.

Q. It is a fact, is it not, that this company in 1945 received credits of \$4,998,648.28 on account of amortization claims?

A. Our inspection related to the period ending April 30, 1944. [1470]

Q. You did not know then that those claims had been allowed? A. No, sir.

Q. You just learned about them from me now, is that right?

Mr. Adams: You mean as to the amount or the fact?

Mr. Phleger: The fact and the amount, both.

A. Yes, sir.

Q. (By Mr. Phleger): With respect to the United States Government freight cut-backs and refunds, did you make any investigation at all, either you or anyone acting for you, of the actual facts with respect to the payments of refunds or the application of cut-backs? A. No, sir.

Q. Do you know whether or not the actual figures which you have used in your estimate here have or have not been used as the basis for reduction of income tax? A. I do not.

Q. Your assumption is based upon the proposition that in years subsequent to 1942 and 1943

(Testimony of James L. Cockburn, Jr.)

and the first four months of 1944 that the company was in fact charged, either paid out or did not collect on account of these amounts, isn't that right? A. That is incorrect.

Q. What was your assumption?

A. The assumption was the Western Pacific Railroad Company could have claimed these adjustments by the government arising out of cutbacks or refunds in subsequent years, could have been [1471] claimed as a deduction in the years 1942, 1943, and the first four months of 1944.

Q. But that assumption is in turn predicated upon the proposition that those amounts were in fact paid out in later years, is that not true?

A. Paid out or withheld?

Q. Yes. A. That is correct.

Q. And did you take into consideration when paid out or withheld in later years, that the company received the income tax benefit of that treatment? A. I did not. [1472]

Q. Did you give any consideration to that at all in this matter of this computation?

A. I did not.

Q. Do you know whether or not the company paid excess profits taxes in the last eight months of 1944? A. I believe they did.

Q. Did they pay excess profits taxes in 1945?

A. I believe they did.

Q. Did they pay excess profits taxes in 1946?

A. They did not.

(Testimony of James L. Cockburn, Jr.)

Q. There weren't any excess profits taxes?

A. That is correct.

Q. Did you make any investigation of the partial debt loss on the Sacramento Northern Railway notes and advances?

A. Yes, we made an analysis of the advances, times and amounts of advances to the company, from the records of the company, which shows the dates and the amounts that were advanced, and the dates of refunds or repayments by the Sacramento Northern to the Western Pacific Railroad Company.

Q. Do you have that computation?

A. Yes, I believe we have those papers here.

Q. I would like to have them.

Mr. Adams: Just one minute. Let us get clear what you are speaking of. Will you ask the witness, please, so we can get an identification of what you would like to have? I did [1473] the same thing with Mr. Buchanan.

Mr. Phleger: It is perfectly clear here. He said he made an investigation of time and amounts of advances made by the Western Pacific Railroad Company to the Sacramento Northern and also the dates and amounts of repayments.

Mr. Adams: Right.

Mr. Phleger: And I asked him for them.

Mr. Adams: Yes. Are you now asking this witness to prepare a new paper, or are you asking him for some paper that he has got?

(Testimony of James L. Cockburn, Jr.)

Mr. Phleger: I am asking him for the paper he just testified—

Mr. Adams: He did not say he had a paper. That is my point. I would like to get an identification of what you are talking about.

Q. (By Mr. Phleger): Do you have a paper which shows the advances and repayments?

A. We have certain working papers showing the listing of the advances and the repayments.

Q. And you will be glad to furnish them to me, will you?

Mr. Adams: Just a minute. I object to that. The witness has his working papers, and I take it we are willing, and have always been willing, that they may be inspected, but that they should be furnished to opposing counsel I do not think is proper, and I did not make that request of your expert witness. [1474]

Mr. Phleger: I do not see the difference.

Q. Do you have them here? Suppose you let me look at them.

A. I believe we have them with us.

(A document was handed to Mr. Phleger.)

Mr. Adams: I would like to have the record in some way indicate the nature of the work sheet that has just been exhibited to opposing counsel. If opposing counsel will be good enough to designate the approximate number of sheets or something in the way of showing the substance of the papers he is now looking at, I would appreciate it.

(Testimony of James L. Cockburn, Jr.)

Mr. Phleger: May it please your Honor, I do not want to take up the time of the Court while I examine this. May it be understood that at the noon recess I will have access to these working papers and have an opportunity to look over them?

Mr. Adams: Certainly. May I ask that some description, counsel, be now placed on the record?

The Court: Let the witness testify what he has produced. Mr. Phleger probably cannot tell at a glance what it is.

Mr. Adams: A question can be addressed to him for response after he has a chance to inspect them.

Mr. Phleger: Let us do what you did, Mr. Adams. Let us request the clerk now mark with an identifying mark every working paper that this witness used in preparation for the testimony that he has just given.

Mr. Adams: I will be very glad to do that. The arrangement, [1475] however, that we made relieved the clerk of that task and we accomplished it privately.

Mr. Phleger: All right. Will you mark them for me?

Mr. Adams: I think that since we marked yours, we might ask you perhaps to indulge the same practice.

Mr. Phleger: I will trust you to mark them.

Mr. Adams: I would certainly trust you to mark them, Mr. Phleger.

Q. (By Mr. Phleger): Do you know whether any advances were made to the Sacramento Northern in 1942?

(Testimony of James L. Cockburn, Jr.)

Mr. Adams: May the witness have his working papers in his hands?

The Witness: If I may refresh my memory from the working papers—Yes, there were reimbursements—

Q. (By Mr. Phleger): I am asking about advances.

Mr. Adams: Will you read the question, please?

(Question read.)

A. Yes, there were.

Q. (By Mr. Phleger): In what amount?

A. \$242,000.

Q. What were they represented by?

A. Cash advances.

Q. Notes? A. Cash advances.

Q. Were there any advances made during the year 1943? [1476] A. No, there were not.

Q. Were there any in the first four months of 1944? A. No, there were not.

Q. Were there any in the last eight months of 1944? A. Yes, there were.

Q. How much? A. \$220,000.

Q. How much were made in the year 1945?

A. No advances made in 1945.

Q. 1946? A. \$370,000.

Q. 1947? A. \$700,000.

Mr. Phleger: That is all I have for the moment of this witness. I would like the noon hour to examine these and other documents and maybe I won't have any further questions.

The Court: Have you got some short witness, or would you prefer to recess?

Mr. Adams: I think I have one short witness I can call. I would like to call Mr. Droit. I have about one question to put to him. I have two short witnesses, your Honor. I will call Mr. Droit and maybe I can call Mr. Mintzer and excuse them both. [1477]

CLARENCE L. DROIT

called on behalf of the defendants; sworn.

The Clerk: Will you state your name, please?

The Witness: Clarence L. Droit.

Direct Examination

By Mr. Adams:

Q. Please state your business and business address.

A. 526 Mission Street, San Francisco.

Q. And you are the secretary of the Western Pacific Railroad Company? A. I am.

Q. And you have held that office since when, Mr. Droit? A. August, 1937.

Q. Mr. Droit, did I ask you to check the records and see whether or not during 1943, 1944 and 1945 there was sent out from your office to the firm of Goodbody & Company in New York any copies of the annual reports for 1943 and 1944?

A. You did.

Q. What did you ascertain with regard to that?

Mr. Clark: Just a minute. I will object to that

(Testimony of Clarence L. Droit.)

upon the ground it is incompetent, irrelevant and immaterial.

Mr. Adams: The sole point of this, your Honor, is to prove notice to the intervener Offerman, who was associated with Goodbody, of a copy of one of those annual reports which contained all the data about this tax matter. [1478]

Mr. Levy: He is an employee of Goodbody.

Mr. Adams: He is just what was described, a customers' broker in Goodbody & Company.

Mr. Levy: He was an employee.

Mr. Clark: We will object to it, your Honor, on the ground it is incompetent, irrelevant and immaterial.

The Court: Overruled.

Q. (By Mr. Adams): The question was, What did you ascertain in that regard?

A. Well, I ascertained that Goodbody & Company were stockholders and appeared on the stock list, and they were mailed a notice of the annual meeting by the Central Hanover Bank and Trust Company, which also contained proxy material and a copy of the annual report.

Q. For what year?

A. The year 1944.

Q. And approximately when was that proxy material mailed? A. June 1, 1945.

Mr. Adams: No further questions, your Honor.

Mr. Clark: Nothing from us, your Honor.

The Court: That is all.

LUCIO M. MINTZER

called on behalf of the defendants; sworn.

The Clerk: State your name to the Court, please. [1479]

The Witness: Lucio M. Mintzer.

Direct Examination

By Mr. Adams:

Q. Mr. Mintzer, do you have with you the schedule which I expect to produce and identify?

A. No, I do not have it with me.

Q. I have it.

I offer as Defendants' Exhibit 49 for Identification a statistical statement on two sheets entitled in this case, "Record of Weekly Sales of Preferred and Common Shares of the Western Pacific Railroad Company on New York Stock Exchange January 1, 1945, to October 31, 1946, as published in 'The Commercial and Financial Chronicle' of New York," and these two sheets show, your Honor, the volume of trading by weeks in the railroad company's preferred and common stock and the weekly range of prices in that stock, the period being from the time the reorganized company took over on the 1st of January, 1945, to the approximate time of the commencement of this litigation here in San Francisco; but since it is set out by weekly dates, it will also show the figures up to the time the stockholders' suit was begun in New York. The purpose of this showing, like the showing with re-

(Testimony of Lucio M. Mintzer.)

spect to the conversion of the income bonds, is to show the change of position that took place in respect of these stock holdings between the time the reorganized company started operating and the time this claim was first asserted. And I am reminded that I have not gone through the [1480] proper formalities in asking Mr. Mintzer to please state his business and business address.

The Witness: I am employed by the firm of Mc-Cutcheon, Thomas, Matthew, Griffiths & Greene.

Q. (By Mr. Adams): Mr. Mintzer, it was at our request that you made this study?

A. It was.

Q. And this is your work? A. It is.

Q. Would you state generally the nature of your business as at present and for some years past?

A. I have handled investments and made recommendations for investments to the partners in the firm with respect to clients' accounts, trusts, and so on.

Q. Is this to the best of your knowledge a correct statement of the record of weekly sales of preferred and common shares of Western Pacific Railroad Company, as identified in the title for the period therein stated? A. Yes, it is.

Mr. Adams: I offer it, your Honor, as Defendants' Exhibit 49.

Mr. Phleger: Your Honor, I object to the receipt of the exhibit upon the ground it is incompetent, irrelevant and immaterial, and particularly

because it shows the prices at which these shares were bought and sold, and seems to me [1481] entirely immaterial, if not misleading. I am willing to stipulate, although I do not even think it is material, that those stocks were traded on in the New York stock exchange during this period.

The Court: The reorganized company?

Mr. Phleger: That is right.

Mr. Adams: Yes. Your Honor, we consider the prices are significant for the reason that in the reorganization plan those stocks were created, and we consider it a part of the equity position before this Court to show, as this exhibit shows, what relation to that value the market value of the stock had from year to year and from time to time prior to the time this claim was first made.

The Court: I do not see what the materiality of that is. What would you say is the materiality? It sometimes happens something you buy is not as good as you thought it was.

Mr. Adams: This much, your Honor: We offered a schedule the other day that we prepared showing that one of the secured creditors in the reorganization was not paid to the extent of some three and a half million dollars. Now, the schedule shows that that stock, which was received by that claimant under the plan, was received at a price of \$62 a share. If this schedule does nothing else in respect of prices, it discloses as a definite fact that at no time thereafter could it possibly be said that that claimant had been paid one

way or another, even in [1482] a loose sense, by an increase in the market price over or above that \$62 figure.

The Court: Well, now, Mr. Adams, suppose I go out and buy some stock in a corporation on the stock exchange, and after I buy it I find out that somebody has some claim which he is asserting against the railroad company or a corporation, for instance, that affects the value of the stock; now, what bearing has my purchase or sale of that stock got on the rights of the parties who were involved in the claim that is presented here? I don't see the connection there, unless you wanted to show that everybody that bought stock in this corporation on the New York stock exchange made a very thorough investigation of the stock to find out whether or not there was a claim of this nature pending before they bought it—which would, of course, be contrary to everything that the American people do. With that assumption, why, then there might be some possibility of showing reliance, and hence a change of position. But of course you couldn't have a change of position without reliance.

Mr. Adams: Well, your Honor would bear in mind that during the period here covered by this report, for example, the annual report of the Railroad Company for '44 was published, contained a full statement about the tax matter, stating that there was this reserve fund, stating that it was there to respond to possible tax liability to the Gov-

ernment—and [1483] nothing was said in that report about this claim, because it hadn't been heard of.

The Court: Well, Mr. Phleger, you don't object to the accuracy of this computation, but merely to the relevancy?

Mr. Phleger: That is right.

Mr. Clark: And we object to the relevancy.

The Court: It may be marked for identification, and I will sustain the objection on the ground that it is incompetent, irrelevant and immaterial.

(The document referred to was marked Defendants' Exhibit 49 for Identification.)

* * *

JAMES L. COCKBURN, JR.
resumed.

Mr. Phleger: I have no questions at this time.

Mr. Clark: We have none, your Honor.

The Court: Any further questions, Mr. Adams?

Mr. Adams: One question, if your Honor please. Maybe there will be two, but it will be the part of one, if I make it two.

The Court: Very well.

Redirect Examination

By Mr. Adams:

Q. Mr. Cockburn, you recall this morning you gave the Court a figure, \$14,800,000 as representing the amount of total tax liability of the rail-

(Testimony of James L. Cockburn, Jr.)

road company on the assumption of a separate return basis, on the assumptions in your Schedule D marked Defendant's Exhibit 41, if the deductions were disallowed. Do you recall that?

A. That is correct.

Q. And you recall also that you stated the difference between that figure and the amount shown on Basis 2 of Plaintiff's 80 was approximately \$770,000? A. That is correct.

Q. Now you mentioned some factors that you said were responsible [1485] for this difference, and one of them was, was it not, the difference in the computation of the carry-overs?

A. That is correct.

Q. Now I would like you, in order to clarify the record, to explain the difference between the method you used in that computation and the method Mr. Buchanan used in his computation on Basis 2; and I might ask you preliminarily, have you checked Mr. Buchanan's computations with him?

A. I have.

Q. You have seen his working papers?

A. I have.

Q. Do you believe you are able to state the basis on which his computation was made as well as that upon which yours was made?

A. I do.

Q. Will you please then state what those two bases were, so that the Court may see the difference?

(Testimony of James L. Cockburn, Jr.)

A. The basis of Mr. Buchanan's computations, as stated in his heading to Basis 2, assumes that the Western Pacific Railroad Corporation and affiliated companies had filed consolidated returns up to and including December 31, 1941. And the net operating loss carry-over and excess profits carry-overs included in his computations for 1942, '43 and the first four months of '44 are taken from the consolidated returns filed, particularly, I think, from the 1942 return, where the carry-over [1486] from 1941 is shown. Our net operating loss carry-overs and excess profits credit carry-overs used in preparation of Exhibit D—

Q. That is Defendant's 41, is it not?

A. That is Defendant's 41. —assumed that separate returns were filed from '39 onward, and that therefore the excess profit carry-over and the net operating loss carry-over years in our computation are those carry-overs which a company would have had going into 1942 had it filed separate returns prior to that time.

Mr. Adams: I have no further questions, your Honor.

Mr. Phleger: No questions.

Mr. Clark: No questions.

The Court: That is all.

(Witness excused.)

Mr. Adams: Now at this time, your Honor, in connection with the evidence just produced, I would like to offer as Defendant's Exhibit 50 a photo-

static copy of what I heretofore referred to as the ruling of the Commissioner of Internal Revenue in the Santa Fe case. This is a photostatic copy of a letter I have given to counsel. My reason for putting it into the record is simply that I am not certain whether or not it is a public-had ruling. The materiality of the ruling would be evident upon examining it. It is a ruling under which provision is made for the cut-backs to be taken into the accounts in the years in [1487] which the transportation took place, for income tax purposes.

Mr. Phleger: We do not object to its competency, but we consider it irrelevant and immaterial.

The Court: I will admit it.

(Photostatic copy of ruling referred to above was thereupon received in evidence and marked Defendant's Exhibit 50.)

WILLIAM A. SUTHERLAND

called as a witness on behalf of the defendant; sworn.

The Clerk: State your name to the Court.

A. William A. Sutherland.

Direct Examination

By Mr. Adams:

Q. What is your address, Mr. Sutherland?

A. Marine Building, Washington, D. C.

Q. What is your occupation?

(Testimony of William A. Sutherland.)

A. Lawyer.

Mr. Adams: If your Honor please, for the sake of brevity may I ask leading questions in regard to the qualifications of the witness?

The Court: Very well.

Mr. Adams: Mr. Sutherland, you are a member of the firm of Sutherland, Tuttle and Brennan having offices in Washington and in Atlanta, Georgia?

A. Yes, sir.

Q. You did your first year of college work at Florida and [1488] received your A.B. from the University of Virginia, your M.A. from the University of Wisconsin, and you graduated from the Harvard Law School in 1917 with an LL.B. degree?

A. Yes.

Q. Of what bars are you a member?

A. I am a member of the Bar of Georgia, the District of Columbia, the Supreme Court of the United States, the Court of Claims, the District Courts in Georgia, the Fourth, Fifth and Sixth Circuit Courts of Appeal, and I think the Second.

Q. And you are a member of the American Bar Association, the Georgia Bar Association, the Atlanta Bar Association, and the Atlanta Lawyers' Club? A. Yes.

Q. You were admitted to practice before the Treasury Department in 1923? A. Yes.

Q. What was your first position after you left law school?

A. I was secretary to Mr. Justice Brandeis

(Testimony of William A. Sutherland.)

of United States Supreme Court for his second and third years on the court.

Q. Were you at any time associated with the Federal Trade Commission, and if so, in what capacity?

A. Yes, when I left Justice Brandeis in 1919 I was with the Federal Trade Commission until the end of 1920 as an attorney examiner.

Q. And you were general solicitor and head of the Law Department [1489] of the Tennessee Valley Authority for a few months in 1933 and 1934?

A. Yes, sir. I did not give up my practice at that time.

Q. You have been engaged in private practice since 1921? A. Yes.

Q. Your firm has had offices in Washington since 1937? A. Yes.

Q. Have you specialized in any particular field of law practice?

A. I have specialized in federal taxes largely since 1923.

Q. Mr. Sutherland, in your opinion would a lawyer engaged to advise on the tax problems of an affiliated group of corporations be expected to advise one of the members of the group, which member had substantial losses, that it had the right, by refusing to join in a consolidated return, to deny to the income corporations in the group the use of the loss deduction to offset the taxable income of the group as a whole, where such member would

(Testimony of William A. Sutherland.)

suffer no tax disadvantage from joinder in the consolidated returns, and where the consolidated return was to be filed after the member sustaining the loss had severed all affiliation with the other members of the affiliated group?

Mr. Phleger: May it please the Court, I object to the question on the ground it is incompetent, irrelevant and immaterial and hearsay. I assume that this is supposed to be some testimony by an expert upon an issue which, I take it, would be either of law or of fact. If of law, I do not think it is an [1490] appropriate matter for expert testimony, and if a fact, it simply calls for the conclusion of this witness. It attempts to usurp the function of the court.

Mr. Adams: The question is directed, your Honor, to what we understand to be an issue in the case as evidenced by questions asked yesterday of one of the lawyers who handled tax matters, whether or not he expressly advised a member of the affiliated group that it had a right to file a separate return. Now, this question is addressed concededly to a well-qualified lawyer engaged in tax practice, and asks him whether in his opinion under the stated assumed set of facts the question that I addressed, which we regard as responsive to that particular issue, and as a question of fact upon which a qualified expert can answer, a question posed upon an assumed set of facts.

The Court: If it is a question that is posed on

(Testimony of William A. Sutherland.)

an assumed state of facts, it is not a question of fact.

Mr. Adams: The assumptions contained in the question, your Honor, we believe are all of the assumptions required to be made upon the record in this case.

The Court: Then it is just expert testimony.

Mr. Adams: It is undoubtedly the testimony of an expert witness that we are offering upon a hypothetical question.

The Court: I never heard of a case in which the lawyer could testify as an expert witness as to any issues in the case, except it be on some special subject, such as foreign law, or [1491] matters with which he might be acquainted and of which the Court might not be acquainted. If we admitted this kind of testimony it would result in each side getting the best lawyers they could think of to come in and tell the Court how to decide the case. It does not seem to me to have a proper place in the trial of a lawsuit.

Mr. Adams: Your Honor, I do not wish to argue this at length, but merely state what I perceive to be the point of the question.

The Court: I understand exactly what you are trying to bring out, but the question is, can you bring in a lawyer to testify as an expert that what was done was properly done? If you can do that in this case, you can do it in any case.

Mr. Adams: Your Honor will bear in mind this

(Testimony of William A. Sutherland.)

question is directed to the conduct of a lawyer; it is not the ultimate issue in the case.

The Court: If it is not an issue in the case, then of course it is not competent.

Mr. Adams: I said to the ultimate issue. I think, as I understand it, there is some contention here, because of the questions asked yesterday, whether the lawyer did or did not give certain advice.

The Court: Suppose the witness testifies and answers your question, and I would be satisfied from all the facts and circumstances of the case that a different result should follow. [1492] Would there arise by virtue of that a conflict that would make a record so that a higher court reviewing it could say the court was making a finding with respect to conflicting presentations of an issue?

Mr. Adams: I would think that as in any case of expert testimony, the testimony is before the court to be weighed and considered as any other testimony. Certainly I do not understand in any case, except where there is no conflict in the testimony, a court is ever bound, certainly with regard to an issue of this sort.

The Court: Even if it was offered as expert testimony, wouldn't the witness have to qualify that he was familiar with all the material facts presented in connection with the matter?

Mr. Adams: We consider that this question embraces all the material facts requisite to an answer to the question.

(Testimony of William A. Sutherland.)

Mr. Clark: I might point out to your Honor that it does not embrace one important fact, namely, that there was an economic divorce some years prior to the termination of the affiliation.

The Court: Mr. Adams, do you have with you any authority which sustains the right to present as competent the testimony of a lawyer with respect to any legal issues in the case, except where it involves some special subject such as foreign law or, in some cases, it is allowed in tax controversies?

Mr. Adams: If your Honor will allow me a moment, I will be [1493] sure of an answer.

The Court: I want to be sure there isn't something lurking in this that I do not know about.

Mr. Adams: We have no authorities to cite on the specific question.

The Court: I think the testimony is incompetent. I will sustain the objection.

Mr. Adams: I will ask one further question.

Q. Mr. Sutherland, in all your experience have you ever heard, prior to hearing the claim asserted in the proceeding now in this court, of a claim by a member of the group of corporations which filed consolidated tax returns to be paid anything by any other corporation in the group, any consideration for the tax advantage resulting from the loss sustained by the claiming member of the group? [1494]

Mr. Phleger: May it please the Court, I object to that question on the ground that it is incompetent, irrelevant and immaterial, calls for the con-

(Testimony of William A. Sutherland.)

clusion of this witness, and is another attempt to usurp the function of the Court.

Mr. Adams: Stating very briefly my answer, because this question is much like that your Honor ruled on with respect to the actors, it is our object to prove as a fact from an experienced counsel in the tax field that this claim had never been heard of by him. We think this is material to the issues in this case and is part of the character of this claim, as a later afterthought. We regard it as a material fact in the case, and this is a part of that proof. It is also responsive to any suggestions that any of the lawyers whose work was involved in handling the tax matter was in any respect other than the work of competent and conscientious lawyers, because obviously if the claim now asserted is one which was beyond the general purview of tax lawyers, then no criticism can be addressed to a lawyer who had not heard of it. Those are the purposes.

The Court: I will sustain the objection. Let me say to you, Mr. Adams, that you can make the same argument on the same subject matter in your briefs, and I, without meaning any disrespect to the witness, would listen to it perhaps even more attentively as coming from learned counsel who have practiced here, and for whom I have respect; I might [1495] consider the argument coming from the attorneys in the case as having more weight with me, since you are familiar with this case, than the testimony of an expert.

(Testimony of William A. Sutherland.)

Mr. Adams: May I say, your Honor——

The Court: That may mean something with regard to losing out on this point, I don't know.

Mr. Adams: May I say, with all due respect, that we would offer to prove that the questions, if the answers should be allowed, would be answered in the negative.

The Court: I beg pardon?

Mr. Adams: I would offer to prove that if your Honor would allow these questions, the answers to each of them would be in the negative.

The Court: Let the record so show.

Mr. Adams: And may I also state for the record that we have had very happy associations with Mr. Sutherland and also with Mr. George Maurice Morris, who have considered some of these problems with us. They have spent considerable time on the case. We would address the same questions to Mr. Morris. May I state briefly what his qualifications would be?

The Court: Very well.

Mr. Adams: Mr. Morris is a member of the firm of Morris, Kix Miller & Baar of Washington, D. C., having offices in Washington and Chicago. He is a graduate of Dartmouth College in 1911, and a graduate of the law school of the University of Chicago in 1916, with a degree of Doctor of Jurisprudence, [1496] and was admitted to practice in Illinois and the District of Columbia, and has practiced before the Supreme Court, several

(Testimony of William A. Sutherland.)

of the United States circuit courts of appeal, the Tax Court, Court of Claims, State and Federal courts of Illinois and the courts of the District of Columbia, and is admitted before the Treasury Department and was formally admitted in 1922.

Mr. Morris is a member of the American Bar Association, the Bar Association of the District of Columbia, the Illinois State Bar Association and honorary member of a number of other bar associations, and currently an official of the Interamerican Bar Association and the International Bar Association. He was Chairman of the Executive Committee of the Interamerican Bar Association and speaker of the House of Deputies of the International Bar Association. Now, Mr. Morris has specialized largely in the field of taxation and administrative law, advising taxpayers and representing them before administrative agencies and the courts. May I take the pleasure of introducing Mr. Morris to the Court?

(Mr. Morris then arose.)

Mr. Adams: I take pleasure in presenting Mr. George Maurice Morris, whose qualifications I have just read, and in stating that offer to prove that Mr. Morris, as well as Mr. Sutherland, would answer these two questions in the negative if your Honor permitted them to be answered.

The Court: Very well. Let the record so show. That is all.

(Witness excused.)

The Court: I don't want it to appear in the record, because sometimes when we read these things over afterwards, in the cold record they read pretty badly, and they are not intended that way. I have no criticism of the qualifications of any of the lawyers who come from afar to testify in these cases. I want to say, however, that I do not think we have to take a back seat out here in the West so far as qualifications of lawyers to testify goes. I know I held court in New York for a couple of months, and I found that our bar out here in the West did not have to take a back seat to the bar in the East. I think they are on a par, one with the other. That is why I said that the argument could be made on the same subject matter concerning which expert testimony was proffered to be made, as well as by the attorneys in this case, for whom the Court has considerable respect.

Mr. Adams: If your Honor please, I neglected to say, and would like to cure the neglect, that Mr. Morris is, as well, past president of the American Bar Association.

The Court: Very well.

Mr. Adams: If your Honor please, with the consent of counsel, in response to an open question upon the examination of Mr. Elsey, I will state that the amount, principal amount, of general mortgage 4½ per cent income bonds which had been converted at June 29, 1946, was \$4,489,300, being converted into stock in the ratio of 20 shares of stock per \$1,000 bond. I would like the record to

show that Judge Sloss, whose appearance in the reorganization proceeding as attorney for the plaintiff corporation upon its intervention, continued to represent the plaintiff corporation in the reorganization proceeding while that proceeding remained pending, and until it was completed.

Mr. Clark: Well, your Honor, in the first place, we think it is incompetent, irrelevant and immaterial, but we don't think we can give the concession without Judge Sloss' own testimony, which was taken on deposition, in which he testified to the limitation of his representation of the plaintiff corporation, as being solely having to do with presenting its position under the plan. Now, we have that testimony. If counsel thinks it is material it can easily be read into the record. We examined Judge Sloss on it.

Mr. Adams: I told Mr. Clark I would be happy to do it that way, and I am perfectly willing to do that, to read it into the record.

Mr. Phleger: Well, let's stipulate it may be copied into the record. It is so many pages.

Mr. Adams: Well, any part you want omitted,—

Mr. Phleger: Let's put it all in.

Mr. Adams: That is all right. We will just introduce [1499] Judge Sloss' record, or deposition, in the record by consent of all counsel.

Mr. Clark: That is satisfactory. The original is on file, your Honor.

The Court: Very well.

Mr. Clark: Oh, yes. And also, may it please your Honor, there is an exhibit that was introduced on that deposition which should go in evidence in connection with it; being a letter, or a copy of a letter, dated November 14, 1939, identified on deposition as Railroad Defendants' Exhibit 555.

Mr. Phleger: Well, I suggest, instead of its being introduced, that it be copied in as part of the deposition.

The Court: Is it not attached to the deposition?

Mr. Clark: Well, it is not, because it was one of the depositions, or one of the exhibits marked on deposition, your Honor, and it is among the original exhibits that came along with all the depositions. It should be copied in along with the deposition at an appropriate place in this record.

Mr. MacKinnon: I think it is irrelevant and immaterial to any issue in the action, but I have no objection if your Honor wants it taken in.

The Court: It may be considered as part of the deposition?

Mr. Adams: Yes.

The Court: Very well.

The Clerk: You wish this copied by the reporter in the [1500] record, is that it?

Mr. Phleger: Yes, in connection with the deposition.

Mr. Clark: Well, if it is just copied in, it won't have to take a number.

(The deposition referred to appears in words and figures as follows:)

MARCUS C. SLOSS

a witness called on behalf of the plaintiffs in intervention, being first duly cautioned and sworn by the notary public to tell the truth, the whole truth, and nothing but the truth, testified as follows:

Direct Examination

By Mr. Clark:

Q. Will you please state your name and present address for the record?

A. Yes. My name is Marcus C. Sloss. Do you want my business address? 351 California Street. My residence is at 2790 Green Street, both in San Francisco.

Q. Are you admitted and licensed to practice law in the [1501] State of California?

A. Yes.

Q. For how long have you been admitted in this state?

A. Well, this month, November, it will be 55 years if we include the time during which I was on the bench.

Q. Were you a Justice of the Supreme Court of the State of California? A. I was.

Q. During what period, please?

A. From February, 1906, to February, 1919.

Q. Are you presently the senior member of the firm of Sloss & Eliot? A. I am.

(Deposition of Marcus C. Sloss.)

Q. During the years 1939 to 1945, were you the senior member of the then firm of Sloss & Turner of this city?

A. I was. I answered yes. I am not quite clear as to when Mr. Turner retired. It may have been earlier than 1945. It may have been '44.

Q. During your practice, Judge, have you specialized in any particular branches of the law?

A. Well, since I left the Supreme Court, I have conducted a general practice, and also have done a good deal of consulting work and work as special counsel in cases after they had reached the stage of being on appeal.

Q. Have you at any time specialized in federal tax matters?

A. No, except so far as they affected general clients of our office. [1502]

Q. Particularly, have you specialized in matters pertaining to corporate income and excess profits taxes payable to the government?

A. I say, except in so far as they affected my clients that were corporations.

Q. And is that true with respect to any work that you may have done concerning the filing of consolidated income and excess profits tax returns by corporations with the Federal Government?

A. No, I have not specialized in those matters particularly.

Q. At one time, were you retained to represent The Western Pacific Railroad Corporation in any matter? A. I was.

(Deposition of Marcus C. Sloss.)

Q. Can you tell us about when that was?

A. The employment began in November, 1939. That was some four years after a reorganization proceeding had been instituted in the Federal Court, and after the Interstate Commerce Commission had promulgated a plan of reorganization, and reported it to the District Court here, for the Northern District of California; and it was at the time when the parties in interest had a right to file objections to the plan.

Q. At the time you were employed by the Corporation, what status did it have in the reorganization proceeding, if any?

A. The Corporation, as I understood then and have understood since, had not been directly represented in the proceeding before the Interstate Commerce Commission leading to the formulation of a plan. It was, however, a party in interest in two capacities: It was the owner of all of the stock, common and preferred, of the operating company; and it also held an unsecured claim of about \$5,000,000.00 against the Company for money advanced; and its holding of stock and its position as an unsecured creditor were both held or found to be without value in the proposed plan of the Interstate Commerce Commission; and it was given no participation in the reorganized company, or in any of the securities that were to be issued under the plan.

Q. What was the status of that plan at the time

(Deposition of Marcus C. Sloss.)

you were retained by the corporation in 1939?

A. The plan had been reported to the District Court, and the District Court had made an order calling upon all parties in interest to file their objections to the plan before a certain date, which, I think, was to be sometime in December of the same year. Following that, there was to be a hearing of the objections, and a decision by the court.

Q. I will show you a document which has been marked Railroad Company Defendant's Exhibit 555 in this case, being a letter dated November 14th, 1939, addressed to the Honorable M. C. Sloss, 111 Sutter Street, San Francisco, California, and signed T. M. Schumacher; and I will ask you whether you received the original of that letter on or about the date it bears, namely, November 14th, 1939?

A. Yes, I received the original of which this is a photostatic [1504] copy about that time.

Q. Judge, does that letter correctly describe your retainer by the Corporation at that time?

A. Yes.

Q. At some time did you cease representing the Corporation?

A. Well, yes. When the reorganization proceeding was completed, and it ultimately went to the Supreme Court of the United States, and after the incidental matters in the District Court here—United States District Court—had been completed, I considered that my employment was ended.

(Deposition of Marcus C. Sloss.)

Q. Approximately when was that?

A. Well, I made a little memorandum of dates from my records in regard to that.

Q. Will you please refer to it?

A. With the exception of the proceedings in the District Court with reference to allowances of fees and expenses to different counsel and to the parties in the proceeding, which, I think, were not terminated until 1945, I think the last matter that I had anything to do with was on the 2nd of June, 1944, when I participated briefly in an argument before Judge St. Sure in the District Court on the question of whether that court had jurisdiction to determine the ownership of accommodation collateral that had been furnished by the Western Pacific Railroad Corporation to the debtor. I think it was to the debtor. It may have been to someone else. [1505]

Q. Judge, during that period, namely, from November 14th, 1939, to June 2nd, 1944, did you represent the Corporation generally in all of its legal problems?

A. No. No, I considered that my employment was limited to representing the interests of the corporation as a stockholder and unsecured creditor of the debtor in the bankruptcy proceeding—or the reorganization proceeding.

Q. During that time, were you ever called upon by the Corporation to give any advice whatsoever in any federal tax matters?

A. No, I was not.

(Deposition of Marcus C. Sloss.)

Q. During that time, were you ever consulted by the Corporation with respect to any federal tax matters? A. I was not.

Q. Specifically, during that time, were you ever called upon to give any advice to the Corporation concerning the filing in its name of a consolidated income and excess profits tax return for the year 1943? A. No.

Q. Were you ever consulted in any manner with respect to that matter? A. No, I was not.

Q. During that period, were you ever called upon to give any advice to the corporation with respect to the filing in its name of a consolidated income and excess profits tax return for the taxable year 1944? [1506]

* * *

The Witness: I was not.

Q. (By Mr. Clark): Were you ever consulted in any respect concerning such return?

A. You are referring to the year 1944?

Q. Yes. A. I was not.

Q. During the period we are discussing, namely, from November 14th, 1939, until June 2nd, 1944, were you ever called upon by the Corporation to give any advice with respect to the filing in its name of a consolidated income and excess profits tax return for the taxable year 1942?

A. I was not.

Q. And were you ever consulted in any manner with respect to such return? A. No.

(Deposition of Marcus C. Sloss.)

Q. During that period, Judge, were you ever called upon to give any advice to the Corporation whatsoever concerning the filing in its name of a claim for refund with reference to income and excess profits tax for the taxable year 1942?

A. No.

Q. Or with respect to the taxable year 1942? (sic.)

A. The same answer. I was not.

Q. Were you ever consulted in any manner at any time on that matter? A. No. [1507]

Mr. Clark: That is all from us.

Mr. Dickerson: No questions.

Examination

By Mr. Adams:

Q. Judge Sloss, in answer to several questions put by Mr. Clark, he inquired if you were called upon to give advice or to consider any other tax matters as stated in his questions; and you answered in the negative. Did you mean by "called upon," that no one called upon you requesting any such consideration or advice?

A. I don't think I quite got the question.

Mr. Adams: Read it, Mr. Reporter.

(Question read by reporter.)

A. Yes, that was my meaning.

Q. In reference to your representation of the

(Deposition of Marcus C. Sloss.)

Holding Corporation in the reorganization proceeding, you referred to your file and noticed that the last activity on your part other than that involving consideration of compensation, was an occasion sometime in the middle of 1944?

A. I don't remember what the date of that was. I think it was a little later. I think that matter was finally decided in Judge St. Sure's court in '45; but I can refer to other papers and get that date for you later.

Q. It is not necessary. I am just trying to be sure that I understood the testimony that you have given to Mr. Clark; and [1508] I haven't any intention to raise a question as to the particular date.

Is it not the fact that your representation of the Holding Company in the reorganization proceedings remained in force throughout the pendency of those proceedings from the time that you first appeared in behalf of the Corporation?

A. It remained in force—you mean until the reorganization was completed in the court proceedings?

Q. Yes. A. Yes, I do think it did.

Q. You did not withdraw from that representation at any time, as far as you recall?

A. No, I never withdrew from it. I have in my file—I happened to see it yesterday—a letter which I wrote, which I can find shortly, which settled a little matter of advancement of expenses between

(Deposition of Marcus C. Sloss.)

my office and Colonel Coulson's office; and in sending him a check for the small amount that was due him, I said that I think that this concludes my services in this matter; and that, I think, was in 1945; but I can find it if you would like to get the date.

Q. It may be that we should want to look at that.

You had in mind in appearing for the Corporation as you did in the reorganization proceedings, that you were appearing as an attorney for the Corporation generally for the purposes indicated by the statute? [1509] A. Indicated by what?

Q. By the statute.

A. Oh, yes. Yes, for whatever came within the scope of that reorganization proceeding.

Q. You received as such attorney regularly the notices of hearings issued out of the reorganization court?

A. Yes. Yes, when I began, I might add, because of the fact that the Corporation had not been directly represented in the prior hearings before the Interstate Commerce Commission, I wrote a letter to the judge and to the parties in interest, calling attention to that fact, and asking whether I would be permitted on behalf of the Corporation to appear at the hearing on the plan, and to file objections, to which he answered in the affirmative; and then about the same time, on behalf of the Western Pacific Railroad Corporation, we

(Deposition of Marcus C. Sloss.)

asked leave to intervene in the proceeding, which leave was granted. If my memory is correct, Mr. Goodrich took the same course on behalf of the Western Pacific Railroad Company, which was also an unsecured creditor.

Mr. Goodrich: That is correct.

Mr. Adams: I have no further questions.

Re-Examination

By Mr. Clark:

Q. Judge, did you ever at any time give any advice whatsoever to the Corporation respecting any federal tax matter? [1510]

A. No, I did not.

Q. And at any time were any facts brought to your attention which made you feel that it was incumbent upon you to take any action or steps on behalf of the Corporation in any tax matter?

A. No. I don't know that this is a qualification of that answer; but, of course, one of the matters which were gone into very thoroughly in connection with the hearings both in the District Court and in the Circuit Court of Appeals and in the Supreme Court, was the matter of the earnings record of the Company, not only before the institution of the proceeding, but during it—even after the decision in the District Court, with the purpose of showing that the property had a greater value than was attributed to it by the Interstate Commerce Commission. And it may be—I have no

(Deposition of Marcus C. Sloss.)

definite recollection of it—that in looking over those statements of receipts and disbursements, there were items of taxes paid or taxes accrued; but I viewed it just as I viewed any other item of expense, without going into the detail or the supporting data; and I viewed it as an item of expenditure.

Mr. Clark: That is all from us.

Mr. Adams: We have no further questions.

Mr. Clark: Mr. Dickerson?

Mr. Dickerson: No questions.

The Witness: If you will permit me, I have that letter [1511] here with me, in case you would like to look at it.

Mr. Adams: Oh, yes. I hadn't appreciated that you had your files with you.

A. Yes. May I volunteer this testimony? I don't think it will do anybody any good or any harm.

Mr. Clark: Yes.

A. But for completeness, I find in my files a carbon copy of a letter dated June 15th, 1945, addressed to Robert E. Coulson, Esq., 40 Wall Street, New York, N. Y.

"Dear Colonel Coulson:

"In accordance with the order of Judge St. Sure dated May 21st, 1945, the Western Pacific Railroad Company has paid Sloss & Turner \$7,000.00, being the amount allowed for services during the period following the decision of the Circuit Court

(Deposition of Marcus C. Sloss.)

of Appeals, together with \$725.02 reimbursement for expenses incurred. The latter amount includes \$705.82, which has been paid to Sloss & Turner by your firm in July of 1943. Under date of July 20th, 1943, you sent us a check for \$780.91. On July 26th, 1943, I wrote you, pointing out that this was an overpayment of \$75.09, the check for which was sent you under cover of the last-mentioned letter. The balance remaining is \$705.82. A check for \$705.82 payable to Whitman, Ransom, Coulson & Goetz, is enclosed herewith."

And then follows the paragraph—the only one that has any bearing here. [1512]

"I take it that this closes my connection with the Western Pacific reorganization proceeding. Let me at this time express my pleasure in the association with you, and my appreciation of your many courtesies. With best regards,

"Yours very sincerely,"

and signed by me.

Re-Examination

By Mr. Adams:

"Mr. Adams: I have one or two more questions, possibly.

"Q. Judge Sloss, during the entire course of your representation of the Holding Corporation in the bankruptcy proceeding, were you entirely devoted, so far as your activities and work were concerned, to the interests of the corporation to the exclusion of any other interested party?

(Deposition of Marcus C. Sloss.)

“A. Yes, entirely.

“Q. And you were entirely free from any direction, domination or control by any other interested party, or any representative or agent of such party?

“A. Yes, my employment—my representation was directed towards getting, if we were able to do so, more recognition of the position of the corporation as a stockholder and as an unsecured creditor.

“Mr. Adams: No further questions.

“Mr. Clark: Nothing further, Judge. Thank you very much.

/s/ “MARCUS C. SLOSS.” [1513]

(The letter referred to reads in words and figures as follows:)

“November 14, 1939

Via air mail.

Hon. M. C. Sloss,
111 Sutter Street,
San Francisco, California.

My dear Judge Sloss:

At a meeting of the Board of Directors of the Western Pacific Railroad Corporation held on October 10, 1939, I was authorized as President of the Corporation to employ local counsel in San Francisco to represent the investment of this Corporation in the Federal District Court of California, Northern District, Southern Division, in the proceedings for reorganization of the Western Pa-

cific Railroad Company. This Corporation, as you know, not only owns all of the outstanding stock of the Western Pacific Railroad Company, but is a general creditor for [1513A] advances made to that company aggregating a substantial amount. Under the Commission plan which is now before the Federal Court in San Francisco for consideration the interest of this Corporation both as stockholder and general creditor is treated as of no value. This treatment of the claims of this Corporation is based entirely upon Commission estimates of future earnings, as both the investment, fully depreciated, in the Western Pacific Railroad Company and the valuation of the property of that company made by the Interstate Commerce Commission for rate purposes considerably exceeds the total of debts of the Western Pacific Railroad Company with accrued interest to date.

Mr. F. C. Nicodemus, Jr., of Pierce & Greer, of 40 Wall Street, New York, N. Y., is counsel for this Corporation. In the pending proceeding for the reorganization of the Western Pacific Railroad Company, however, he has appeared as counsel for that company, the debtor in the proceeding, both in the Court and before the Commission. He will continue to appear in the proceeding in that capacity. It is the view of the Board of Directors of this Corporation that it should have completely independent representation in the Court in order that its claims against the debtor, both as stockholder and as a general [1514] creditor, may be

effectively pressed upon the Court. While you will not be in any sense under the control or direction of Mr. Nicodemus, he, as counsel for the debtor, will be glad to help you or cooperate with you in any way you may wish, not inconsistent with his desire to maintain a position of neutrality as between the various classes of security holders.

This Corporation has about 5,000 stockholders. Mr. A. C. James and companies in which he is the dominating stockholder own approximately 40% of the stock of this Corporation. Mr. James' interests are represented by Mr. Coulson who is formally appearing in the reorganization proceeding for the A. C. James Co., which is a secured creditor of the Western Pacific Railroad Company. Mr. Coulson has told me that he is prepared to cooperate with you to the fullest extent you may desire in the preparation of your objections on behalf of this Corporation to the Commission's plan of reorganization, and in your presentation in support of such objections.

Mr. Coulson has further advised me that he has arranged to secure for you an assurance from the Curtiss Southwestern Company, that to the extent your reasonable and proper fees for services in this reorganization proceeding are not allowed by the Court in the [1515] proceeding or paid by this Corporation, the Curtiss Southwestern Company will make such payment to you. The Curtiss Southwestern Company is desirous in its own interest as a substantial stockholder in this Corporation that

an adequate and effective presentation of the case for the equity be made in the San Francisco court.

Yours very truly,

Original signed by

/s/ T. M. SCHUMACHER,
President."

Mr. Adams: Now I should like to call Mr. Levy.

Mr. Levy: Are you referring to me, Mr. Adams?

Mr. Adams: No, the witness is ready to testify, I believe.

Mr. Levy: I was prepared.

Mr. Adams: I think you were forewarned, as well.

Mr. Levy: Nevertheless it was quite a shock.

WILLIAM G. LEVY

called as a witness on behalf of the defendant, sworn.

The Clerk: Will you state your name to the Court, please?

A. William G. Levy, L-e-v-y.

Direct Examination

By Mr. Adams:

Q. Where is your place of business, Mr. Levy?

A. 526 Mission Street.

Q. That is the office of the Western Pacific Railroad Company? A. That is correct.

(Testimony of William G. Levy.)

Q. And what is your office in the railroad company?

A. I am the auditor of the freight and passenger accounts.

Q. You have been engaged in business for the railroad company—that is, been an employee of the company—for a little over 25 years?

A. That is right.

Q. How long have you been the auditor of freight and passenger business?

A. Since July, 1948. [1517]

Q. And before that you had been assistant auditor of freight and passenger revenues?

A. Assistant auditor of freight and passenger accounts.

Q. And how long have you held that position?

A. Since September, 1937.

Q. And prior to that time you held various positions in the auditing department of the railroad your duties and responsibilities as auditor of freight and passenger revenue accounts?

A. That is correct.

Q. Now will you please describe the nature of your duties and responsibilities as auditor of freight and passenger revenues?

A. I am in charge of the department where we audit all of the freight and passenger revenues derived from the agents' accounts and inter-line accounts and also government accounts.

Q. Is your department a section of the auditing department? A. Yes, it is.

(Testimony of William G. Levy.)

Q. And who are your immediate superiors?

A. Mr. Gosney, the general auditor, and Mr. Strachan, the assistant general auditor.

Q. Now are you familiar with the handling of government accounts?

A. I am. That is one of the—

Q. That work is under your jurisdiction?

A. Yes, it is.

Q. Are you familiar with the terms "cut-backs" and "refunds"? A. Yes, I am. [1518]

Q. Please state what your understanding of these terms is as regards government freight accounts.

A. Well, the government pays our bills prior to audit. They have been doing that for a good many years. Then when they get around to auditing it—it is quite a ways behind—they detect what they believe are overcharges, and they file claims with us for them. In some instances we make the refunds promptly, but in other cases when we do not, the government makes deductions from a current bill that they happen to be paying, and that deduction is termed a "cut-back."

Q. Now were you asked by Mr. Gosney to prepare an analysis of the cut-backs and refunds made since May, 1944, on government freight traffic that terminated on the Western Pacific system for the purpose of determining the total amount of such cut-backs relating to traffic moving in each of the years '42, '43 and the first four months of '44?

(Testimony of William G. Levy.)

A. Yes, I was.

Q. And when were you asked to make that analysis?

A. In the latter part of August, 1948.

Q. And did you make it? A. Yes, I did.

Q. When was it completed?

A. Early in October, '48.

Q. Was this analysis made by employees of the railroad company in your department under your personal supervision? [1519]

A. Yes, it was.

Q. Please describe how the work was done.

A. Well, I designated certain persons from the office to gather the information from the regular records and other persons to sort it according to the years, and finally operators to tabulate the figures to get the final results.

Q. Now I hand you a carbon copy of a tabulation entitled, "Re-Distribution of the Debits to Freight Revenue made during the Period 1944 to July 1948, inclusive, resulting from Government Cut-backs and Refunds on Government Shipments Terminated on the Western Pacific, Segregated to Year in which Traffic Moved," and I also hand you, Mr. Levy—strike that. I am handing you this carbon copy (handing to witness).

I have furnished counsel with copies of this sheet.

Is that a copy of the report which you rendered upon this subject? A. Yes, it is.

(Testimony of William G. Levy.)

Mr. Adams: Now, if your Honor please, I will ask, in lieu of marking the carbon copy, that, with the consent of counsel, a ribbon copy, which has been made from the carbon copy, be marked as Defendant's 51 for identification.

(Analysis prepared by the witness referred to above was then marked Defendant's Exhibit No. 51 for identification.)

Mr. Clark: Have you an extra copy there, Mr. Adams?

Mr. Adams: Yes, and I will ask that a copy of this be handed [1520] up to the Court.

(Copy of report handed to the Court through the Clerk.)

Q. (By Mr. Adams): Mr. Levy, do you believe the figures shown on the report are correct?

A. I do.

Q. Do they include any cut-backs or refunds that were made after July 31, 1948?

A. No, they do not.

Q. Can you tell me approximately the total amount of refunds and cut-backs that have been made since July 31, 1948, with regard to traffic terminating on the Western Pacific system?

A. They amounted to \$322,251.64.

Q. And what, approximately, was the Western Pacific's share of that amount?

A. I estimate that would be \$109,000.

Q. Are you continuing to receive claims for re-

(Testimony of William G. Levy.)

funds and cut-backs from day to day with respect to government traffic handled during the war years?

A. We are.

Q. Can you make any estimate of the total amount of refunds and cut-backs which may eventually be made with regard to wartime traffic?

Mr. Phleger: I object to that on the ground it calls for the conclusion of the witness.

Mr. Adams: I submit it, your Honor. [1521]

The Court: Sustained.

Q. (By Mr. Adams): Now, Mr. Levy, referring to Defendant's 51 for identification, the schedule, are any of the amounts shown in that schedule still in dispute? A. Yes, there are.

Q. In other words, some of the amounts which you had in this schedule are in dispute?

A. Yes, there are a good many items on which we rebilled the government to protect our claims, but most of those have either been withdrawn or settled. However, there is the amount of \$355,-300.41, which we have not yet withdrawn as to these claims and of that amount I estimate that—

Mr. Phleger: Well, now, I ask that—

Mr. Adams: Go right ahead. I ask that the witness' answer not be interrupted.

Mr. Clark: He wasn't asked to estimate anything.

Mr. Phleger: I submit the answer is not responsive.

Mr. Adams: The objection was interpolated in

(Testimony of William G. Levy.)

the middle of the witness' answer. I wonder if the answer may not be completed, and then would be a proper time for the objection, after the question has been answered.

The Court: Well, can't the witness answer it a little more briefly, and then if it is necessary to make an explanation you may ask the witness. That gives your opponent an opportunity to object; otherwise he has to interrupt. [1522]

Mr. Adams: Surely.

Q. Now a moment ago, Mr. Levy, you mentioned the amount \$355,300.41, as being the aggregate of the amount still in dispute, which related to Defendant's 51 for identification?

A. That is right.

Q. Now approximately what part of that \$355,300.41 is the Western Pacific's share?

A. I estimate it to be \$120,000.

Q. Now taking the figures on Defendant's 51 for identification, which aggregate \$2,036,186.84, are those amounts the Western Pacific's share of cut-backs and refunds? A. They are.

Q. And they do not include the share of such cut-backs and refunds chargeable to connecting carriers? A. They do not.

Mr. Adams: I will offer Defendant's 51 for identification as Defendant's Exhibit 51, your Honor.

Mr. Phleger: Your Honor, I would like at this moment to make an objection, if this witness is

(Testimony of William G. Levy.)

not prepared to testify as to the years in which these payments were paid out. Otherwise, it is totally misleading, and I think is only a part of the story. It purports to say the year in which the transportation occurred, and we think we are entitled to know the year in which the payments or cut-backs were made. Now is this witness going to be prepared to testify to that? [1523]

Mr. Adams: Are you, Mr. Levy?

A. You are talking now about which figure?

Q. This same statement.

A. The statement of \$2,000,000?

Q. Yes, this \$2,000,000 statement shows the amounts of cut-backs and refunds on the debits between '44 and '48, which are related back to the years by determining the times when the traffic moved, is that right? A. That is right.

Q. Now then, what Mr. Phleger wants to know is, can you then translate these figures back again to the years in which the debits took place?

A. I can.

The Court: You mean the payments took place?

Mr. Adams: Or, as is stated here, the debits to freight revenue made. The same thing.

A. I can say they were all made subsequent to April, 1944.

Q. And they were made during the period May, '44, to July, '48? A. That's right.

Mr. Adams: So much shows here.

Mr. Phleger: I still object, because it is our

(Testimony of William G. Levy.)

position, and I think it is quite evident, that where a cut-back or refund credit, tax advantage was taken of it, and if the cut-back occurred in the last eight months of 1944, then this defendant received just as much advantage taxwise as if it had been allowed [1524] in this year, and so on, so that unless we know the years in which the tax advantage was taken, we have but part of the story. Now as I understand it, the exhibits put in evidence by Mr. Cockburn simply gave the gross tax effect in those years and gave no credit whatever for the tax advantage which in fact had been received, and we think we are entitled to have evidence of that if this is going in. [1525]

* * *

The Court: Wouldn't you then, in order to make that picture complete, have to show what the tax was in the years in which these refunds and cut-backs were advantaged by the corporation and then credited back in the hypothetical case? Otherwise it would not be a due reflection.

Mr. Levy: That is exactly what the government required in the Atchison ruling, and they so stated expressly.

Mr. Adams: The Atchison ruling is before your Honor. Of course, as far as the government is concerned, you are not going to get your deduction twice. That has been ruled more than once, and what opposing counsel are suggesting here is one way in which to determine the net tax savings. They say we can't have our deductions twice, but

(Testimony of William G. Levy.)

they put us against the proposition that we are not allowed to calculate anything on a hypothesis because, in order to hypothesize at all, you have to hypothesize something that is different from what took place. Now, I think it is true if you want to carry your tax calculations in and out and through in subsequent years, you are going to have different [1526] consequences, and then you are going to have consequences that pile on consequences, because that is the way the tax laws work. But, I take it, that this evidence as it stands is evidence of the amount of the cut-backs during those years. Now, as is suggested by opposing counsel, we need another specification of these figures—I think I am right; I will ask Mr. Levy—that we did not get the tabulations of the particular years from which they were taken when they were taken to these years.

Q. Is that right, Mr. Levy?

A. Will you repeat that question?

Q. (By Mr. Adams): Did you in making these calculations which carry all these figures back to the years when the traffic happened, did you also note the years in which the payments were finally received? In other words, in which the cut-backs finally operated? A. No, we did not. [1527]

* * *

Mr. Adams: Before Mr. Levy addresses the court, may I ask the witness one question because of the suggestion in the last remarks of counsel

(Testimony of William G. Levy.)

that it would be easy to get the figures he would like to get? I would like to ask the witness how much work would be involved in picking the items making up these figures and positioning them with respect to the years in which the debit to freight revenue were made.

The Witness: It would be quite a job. It would take about—— [1532]

* * *

The Court: How else could you find out what the effect was of the payments which were made unless you recalculated all the income tax returns in the years in which these payments were actually made?

Mr. Adams: Let me see if I can get this clear with Mr. Levy.

Q. Mr. Levy, what you did to get this figure showing the amounts with respect to the time when the traffic was handled was to look at all the bills and get identification one by one of the traffic handled any time with relation to the cut-back or refund, is that right? A. That is right.

Q. Now, then, what you will have to do to get a figure after the time when the cut-back was taken into your accounts—how will you do that?

A. I just have to rearrange the very same records from which these figures were secured according to the date on which the deductions were made from our earnings. [1534]

* * *

(Testimony of William G. Levy.)

Mr. Adams: Your Honor, as to the offer of Defendant's 51 [1537] for identification in evidence, I have concluded to submit the offer without a request for leave to supplement, and take a ruling upon it as the record stands.

The Court: Well, I will reserve ruling on the admission of this exhibit until I have an opportunity to look at all the evidence in the case.

Mr. Adams: I have no further questions of Mr. Levy.

The Clerk: The exhibit will remain marked as 51 for identification, your Honor?

The Court: That is right. I will reserve ruling on the admission of the exhibit.

Any questions?

Mr. Phleger: No questions.

Mr. Clark: Nothing from us.

The Court: You may be excused.

(Witness excused.)

Mr. Adams: Your Honor, at this time I have some documents to offer for the record, and I will state briefly the purpose as I produce the documents. In support of the showing that the plaintiff corporation had no use in itself for its stock loss, we offer photostatic copies of the corporation income and declared value excess profits tax returns of the corporation for the year 1945, and the corporation income tax return of the corporation for the year 1946. I had made request that the plaintiff produce the originals, but I take it it would

be satisfactory [1538] to produce photostatic copies. They might be Defendant's Exhibit 52.

Mr. Phleger: I object to them upon the ground they are incompetent, irrelevant and immaterial.

Mr. Clark: Same objection, your Honor.

Mr. Phleger: Just because we are poor, it is not a matter of evidence. It hasn't anything to do with it.

The Court: Well, there is no objection as to the return itself?

Mr. Phleger: No, not on the ground of competency.

The Court: All right, let it be marked.

Mr. Clark: What is the number on it?

The Clerk: 52.

Mr. Adams: 52A and B?

The Court: For 1945 and 1946, did you say, or '44 and '45?

Mr. Adams: No, '45 and '46. And I direct attention in the '45 return to the amount shown under the net operating loss deduction of \$42,403,-256.08, being the remainder of that big loss after portions of it had been taken up in the prior returns.

The Clerk: The return for '45 will be marked 52A and the return for '46, 52B.

(Return for 1945 and return for year 1946 were marked 52A and 52B in evidence, respectively.)

Mr. Adams: Now, your Honor, I desire to read a resolution of the Board of Directors of the West-

ern Pacific Railroad Corporation [1539] at a meeting held September 5, 1935, my purpose being to show the fact that the plaintiff corporation recommended the appointment of Mr. Schumacher as one of the two trustees. I will read the resolution.

Mr. Phleger: Just a moment. We—

Mr. Adams: Just a moment; from page 927 of the record.

The Court: You say you admit that?

Mr. Phleger: We don't think it is material, but we will admit the fact.

Mr. Adams: May I read it?

Mr. Phleger: We won't agree to the admissibility, but we will admit the fact.

Mr. Adams: The fact being that the Board of Directors of the corporation on that date adopted a resolution as owner and holder of all the capital stock of the Western Pacific Railroad Company, recommending the appointment of Mr. Schumacher as one of the two trustees of the property of the Western Pacific Railroad Company, to be appointed at a hearing.

Mr. Phleger: Yes.

Mr. Adams: Very well, your Honor.

Now, I desire to offer as Defendant's 53 a photostatic copy of a letter of November 28, 1943, addressed by A. R. Baldwin, then an officer of the Western Pacific Railroad Corporation in New York, to C. M. Levey, president of the Western Pacific Railroad Company. [1540]

Mr. Clark: That is not '43, is it?

Mr. Adams: '23.

Mr. Clark: 1923?

Mr. Adams: Yes, right. And I will read briefly from it:

"I am enclosing herewith two statements showing the taxable income as reported to the Commissioner of Internal Revenue by the Western Pacific Railroad Corporation on consolidated returns for the years 1921 and 1922, and proposed allocation of the taxes to the various companies, the income of which is included in the returns. The total tax for 1921, \$31,813.09, was originally paid by the Western Pacific Railroad Company; and of the tax for 1922, \$114,929.64, three-quarters has been paid by the Western Pacific Railroad Corporation, which company will pay the remaining one-quarter, which will be due December 15, 1923. The method of allocation, vis., prorating the entire amount among the companies showing taxable income, is, so far as we are able to determine, the practice followed by other companies making consolidated returns."

Mr. Phleger: Object to that on the ground it is irrelevant, incompetent and immaterial. It is over 20 years before the events here in litigation.

Mr. Adams: Well, the showing previously made being that the practice there described was since continuously followed. [1541]

The Court: Well, you have already in evidence an exhibit which factually shows the manner in which the returns were filed. What good does it do to put that letter in?

Mr. Adams: Particularly because the author, who describes the arrangement, refers to it as being in accordance with the general practice among railroads.

Mr. Clark: Which has already been proved, your Honor.

The Court: I don't see the competency of that, either.

Mr. Adams: I don't want to argue it, your Honor.

The Court: I think you have everything in the record that you need so far as the factual situation is concerned, in this very voluminous exhibit which gives all the facts as to what was done. I think this unnecessarily encumbers the record. I am inclined to be as liberal as is possible, but I think there is no need to put in a letter of 1923 in this litigation, because whatever is in evidence is admitted in evidence, and I am supposed to look at it, and so an alert lawyer is going to call attention to some conspicuous phrase in some document in 1923 when this case gets up into the Circuit Court, the record will show now that in my opinion, it just doesn't serve any useful purpose so far as the issues in this case, and I will sustain the objection.

The Clerk: Marked for identification, your Honor?

The Court: Oh, yes, of course.

(Letter dated November 28, 1923, referred to above was then [1542] marked Defendant's Exhibit 53 for identification only.)

Mr. Adams: Your Honor, I offer as Defendant's Exhibit 54 a series of letters, and I will state the nature of the letters and my purpose in offering them. The nature of the letters is this: It is correspondence between counsel to the corporation and Mr. Curry, first as secretary and treasurer and later as president of the corporation, concerning stockholders' meetings. It is offered in response to Plaintiff's Exhibit 19, which is a schedule of the corporation's stockholders' meetings, 1935 through 1948. It would not be offered at all were it not for the fact that that schedule is in the record now.

The Court: That schedule merely lists the dates of stockholders' meetings.

Mr. Adams: The point of the schedule, as I understand it, is to show that there were numerous meetings at which no quorum was present. The point of these letters is to show that in the letters consideration is given from time to time to the desirability of sending out proxies; the fact being that with proxies entirely outside of the James holdings, a meeting could have been held. Those gentlemen, the corporation officers, and the counsel, considered the matter and decided against it. We think that if the plaintiff's exhibit 19 is to stand in the record as indicative of anything, that we are entitled to put in the responsive showing.

The Court: You mean as to why the stockholders' meetings [1543] were not held?

Mr. Adams: Precisely.

The Court: If that is the point of the correspondence, I think it would have bearing.

Mr. Adams: It is offered for that purpose.

The Court: Well, are you going to offer a lot of letters? What do they say? What do they talk about in those letters?

Mr. Adams: Well, take the first one, in order, which is addressed to counsel by the secretary and the treasurer of the corporation, and it asks:

"I should like to have your opinion as to how this year's meeting should be handled. That is, will we pursue the same course as we did last year, sending out notices only, or should we proceed in the regular way? If we do the latter, it will entail considerable labor and expense, and it will be necessary on next Wednesday's meeting of the Board to name a proxy committee, approve form of proxy, and a proxy statement."

The Court: And what is the answer to that letter, or is that what you are——?

Mr. Adams: Yes, that letter is April 23, 1940, counsel's letter in reply—or August 23, rather, counsel's letter in reply of August 28, of the same subject matter on the same question says: [1544]

"It is our judgment that you should this year pursue the same course you pursued last year; that is, issue the notice in the usual form, but do not name a proxy committee or request proxies.

The Court: Now what counsel was that?

Mr. Adams: Mr. Nicodemus.

The Court: Well, I don't suppose that your opponents are going to object to this.

Mr. Adams: It is offered only in response to

their showing about the stockholders' meetings in the absence of quorums.

The Court: And all the letters are along the same line?

Mr. Adams: Yes, your Honor.

The Court: Is there no objection?

Mr. Clark: We haven't seen them.

Mr. Phleger: I have no objection.

Mr. Adams: They are 700 to 714.

Mr. Clark: If that is the only purpose, there is no objection. I don't know what is in them.

The Court: Well, Mr. Adams has stated the gist of them. I assume that is what they are offered for.

Mr. Clark: Well, if that is the only purpose, there is certainly no objection.

The Court: Well, do you want them marked as one exhibit?

Mr. Adams: Yes, if your Honor please, Defendant's 54, [1545] consisting of a document now marked Railroad Company Defendants' 700, and those following, to 714 inclusive.

(Railroad Company's Exhibits 700 to 714 referred to above were thereupon received in evidence and marked Defendant's Exhibit No. 54.)

Mr. Adams: Now I have a set of letters which I can identify for counsel as Railroad Defendant's 410, 411, 413, 414, 417—417 includes a lawyer's memorandum—Interveners' 224 and 228; and I will state the nature of these letters.

Plaintiffs put in the exhibit Plaintiff's 45, which is an opinion rendered by Mr. Polk to the corpora-

tion with respect of Delaware franchise tax. The interveners put in on the same subject Interveners' Exhibits 5, 6, 7 and 8. We offer these documents, your Honor, which are dated in the years 1944 and 1945, and are correspondence between Mr. Curry, or rather, by Mr. Curry and by Mr. Nicodemus, dealing with that subject matter in response to the apparent effort of our adversaries to show treatment of this subject by Mr. Polk. We offer these to show that the subject was dealt with between the corporation and its own counsel, Mr. Nicodemus, at the same time.

The Court: Are counsel familiar with the correspondence?

Mr. Phleger: Yes. We have no objection to it at all.

Mr. Clark: Limited to that purpose, we have no objection, your Honor.

The Court: Very well.

Mr. Adams: Defendants' 55?

The Clerk: Defendants' 55.

(Railroad Defendants' Exhibits on deposition 410, 411, 413, 414, 417, and Interveners' Exhibit 224 and 228 were received in evidence and marked Defendants' Exhibit 55.) [1547]

Mr. Adams: Now, your Honor, we make an offering in response to the issue suggested upon yesterday's examination, concerning whether or not the plaintiff corporation knew that it had a right to file a separate return. The document which I now offer consists of the following: Interveners' 275,

a letter from the General Auditor in San Francisco to Mr. Curry asking if it were the intention of the corporation to file a consolidated return—

Mr. Clark: For what year, please?

Mr. Adams: I read you the date of the letter, didn't I? The date of the letter is February 8, 1941, and it is for the year 1940. Mr. Curry's letter of February 10, '41, stating:

"I have given this matter careful thought and deliberation, and feel that in accordance with the provisions of Section 730(a), the most equitable arrangement would be for us to dispense with the filing of a consolidated return in this particular instance."

Intervenors' 279, a telegram of March 6, 1941, addressed by Mr. DeGraff to Mr. Curry:

"Do you wish me to prepare tentative declared value excess profits tax returns for each of the companies?"

Mr. Curry's telegram to Mr. DeGraff, Intervenors' 280—these are all deposition numbers—of March 7, 1941, reading [1548] in part as follows:

"Find in looking into matter our accountant, who resigned in February, misunderstood just what is required. Holding company will file consolidated return as in previous years."

Intervenors' Exhibit 80, telegram from Mr. Curry to Mr. DeGraff of March 1, 1945, reading in part as follows:

"By March 15 we will file here tentative consolidated returns for corporation for entire year in-

cluding its subsidiaries, to May 1, and you will file in San Francisco tentative consolidated return of company and its subsidiaries from May 1 to end of year, and consolidated return of Western Realty and its subsidiary from May 1 to end of year. As you know, one-fourth estimated tax liability must be paid at that time. These tentative returns are not binding, so if, after further calculation, it is found more advantageous to file separate returns, we will do so before June 15."

The Court: What year is that?

Mr. Adams: That is a telegram dated March 1, 1945, and refers to the returns for the year 1944.

I offer these documents as Defendants' 56.

Mr. Phleger: Your Honor, I don't think these are material, but I do point out the fact that here is counsel dumping in a [1549] lot of exhibits like that. Mr. Curry was here on the stand, and he testified that all these type of wires were prepared for his signature, and he just signed them. I think it is highly improper at this stage of the trial to start in dumping in letters and telegrams sent by witnesses who have appeared and testified on the very subject. This should have been brought in on cross-examination of Mr. Curry.

Mr. Clark: Your Honor, I think Mr. Adams will concede that that last telegram he read from, with respect to the '44 returns, was established on deposition to have been prepared by Miss Valouch under Mr. Polk's advice.

Mr. Adams: As to the latter, I don't know, but

I am quite confident it was prepared by Miss Valouch.

Mr. Clark: Yes, although signed by Mr. Curry.

Mr. Adams: Well, Mr. Curry testified about all this practice. I have no purpose to contradict Mr. Curry's testimony in any respect, but what I do say is this, your Honor: The issue to which this response was directed was raised yesterday, presented to us yesterday, when a point was made that there was some kind of a difference between advising that it was preferable to file consolidated returns from a tax standpoint and advising that you had a right to file separate returns. That is the reason these things come in.

The Court: I think the testimony is limited to just whether or not the witness Polk had given advice, and there [1550] was some difficulty in getting that question squarely put and answered; but that was the extent of the examination on that subject, just as to whether or not he had made that statement to them. I do recall that the Court stated that that didn't close the door to you to show that there was an understanding on that subject on the part of the parties.

Mr. Adams: This is the current record that we offer in writing, and in response to that question.

Mr. Clark: We have no objection to it, your Honor.

Mr. Phleger: Well, it will be stipulated, will it, that with respect to the last telegram, that it was written by Miss Valouch under the direction of Mr. Polk and signed by Mr. Curry?

Mr. Adams: Whatever the record shows; and

Mr. Curry's deposition I will agree to. I have no recollection of any statement one way or the other relating to this particular telegram to Mr. Polk. If you have a recollection of that, please bring the record up, Mr. Phleger. We will agree on the deposition statement.

Mr. Clark: Well, it will take some time for us to find that pinpoint in the Curry deposition. I may be able to find it within a very few minutes.

The Court: Well, the correspondence may be admitted. I think the objection is not as to the admissibility, but really to the weight of these documents. [1551]

The Clerk: Exhibit 56.

(Interveners' Exhibits 275, 276, 279, 280, 80, on deposition, were received in evidence and marked Defendants' Exhibit 56.)

Mr. Adams: Now further with respect to the tax matters, and having reference among other things to the testimony of Mr. Cockburn on the repositioning of the loss of the Deep Creek Railroad Company, and having reference also to the current record of the disposition of tax questions by Mr. Curry, I offer two letters, Railroad Exhibits 249 and 255, each of these being from Mr. Curry to Mr. DeGraff, and to indicate what I have in mind, I will read briefly from one of them.

Mr. Clark: Just a moment, please.

Mr. Adams: The dates are July 14, 1942, and August 25, 1942.

Are you ready?

Mr. Clark: Just a moment. Yes.

Mr. Adams: Exhibit 249 says, the second paragraph:

"With reference to the losses sustained account abandonment of Deep Creek Railroad, it has occurred to us that this loss might be considered by the Internal Revenue Bureau as a 1939 loss; in view of the fact that the Interstate Commerce Commission issued certificate permitting this abandonment July 1, 1939." [1552]

And in 255, from the second paragraph:

"From the information contained in our records, it appears this loss should be charged off in 1939, as it is our understanding the Revenue Bureau has ruled such losses should be written off the year the securities have been ascertained as worthless. However, due to the large amount involved, we would not want to take it out of 1940 unless we are certain that there is no possible reason for keeping it in that year."

Mr. Phleger: I submit these are totally and wholly immaterial and irrelevant. They are written in 1942 about tax transactions in '39.

Mr. Clark: They are also the type of letter, your Honor, that Mr. Curry testified was prepared by Miss Valouch in each instance, regarding tax matters, and he is not here to give us the benefit of that testimony, if there is any effect to be argued from that.

Mr. Adams: Your Honor, we have said before, and I think it is a fair statement, that the current written record at the time is the best evidence. I do

not offer this in any wise as contradicting any testimony that Mr. Curry gave. I offer it as current evidence of the things that he dealt with at the time.

Mr. Phleger: Well, then, it was certainly proper cross-examination [1553] of Mr. Curry; it is directed to showing that Mr. Curry, I suppose, was a very able tax man.

Mr. Adams: No, no, that is not a proper statement.

Mr. Phleger: Now, the appropriate time to have submitted this was when Mr. Curry was here.

Mr. Adams: I won't argue it further.

The Court: Well, is there very much materiality to this?

Mr. Adams: Your Honor has heard all the material that I consider significant.

The Court: This is the last document?

Mr. Adams: No, your Honor, I have two or three more.

The Court: Well, I can't see any particular materiality to it, but what bothers me more is that counsel may feel that it is a subject that they might want to cover, and Mr. Curry is gone—or is he still here?

Mr. Phleger: I think he is leaving tonight or tomorrow morning. We wouldn't counter it. It is wholly immaterial and irrelevant. That is the only point; it is just making a bigger record here, and we think it is wholly unnecessary.

Mr. Adams: We haven't caught up to the other party's numbers yet.

The Court: Well, I understand from Mr. Adams that we are getting to the end of the rope, so I think I will let it in.

The Clerk: 57. [1554]

(RR. Defendants' Exhibits 249 and 255 were received in evidence and marked Defendants' Exhibit 57.)

Mr. Adams: Now, your Honor, I offer as Defendants' Exhibit 58 a document now marked Railroad Defendant's Exhibit 950, being a copy of a letter dated December 17, 1945, addressed by Mr. Elsey to Mr. Wood, or to Wood, Walker & Company, 63 Wall Street, New York, and containing the following. The letter is written in answer to an inquiry from that company.

"With respect to the stock of the Western Pacific Railroad Company, I think that perhaps the best explanation is that contained in our 1944 annual report under the heading of 'Taxes,' which is quoted below."

And then follows the complete quotation of the statement under the heading of "Taxes," contained in the 1944 report.

We offer this as evidence of notice to the director Willis Wood, who was one of the directors of the plaintiff corporation at the time of this letter, and in view of the fact, your Honor, that his deposition here read in evidence indicates that his recollection was not clear or definite with regard to this matter, and he had some recollection that he did not know about it long after the date of this letter.

Mr. Phleger: Your Honor, that is a letter to the statistical department of a firm of which Mr. Wood was a limited partner, and he has testified in his deposition, which has been introduced in evidence, that he had no notice and received no [1555] notice from it.

The Court: This is a letter that went to what firm?

Mr. Adams: Mr. Willis Wood's firm, he being a limited partner in that firm. You recall the testimony that he had been a partner in a variety of investment houses, and this is the latest one, Wood, Walker & Company, in which he is now a limited partner. The gentleman is some 77 or 78 years of age at this time. This is the gentleman who had been for a good many years a member of the official body of the New York stock exchange.

I am just offering it to prove notice, your Honor, because these gentlemen's recollection of what they knew about this, in this case, was quite obscure.

The Court: Well, this elderly gentleman who was a limited partner in this firm in this period—I am now supposed to draw from this letter some evidence that he had notice?

Mr. Adams: Certainly. What this letter proves is that the very document that would give him notice went to his company. It was available, and we think that it is material in showing that, regardless of the inference your Honor draws further from it—

The Court: Well, I will sustain the objection.

Mr. Adams: May it be marked, if your Honor please, for identification as Defendants' Exhibit 58?

The Court: Yes. [1556]

(Letter dated September 17, 1945, Elsey to Wood, Walker & Company, was marked Defendants' Exhibit 58 for identification.)

Mr. Adams: Now next, your Honor, I desire to offer Railroad Defendant's Exhibits 795, 796 and 797. These are, respectively, schedules as respects Russell M. Van Kirk, deceased, of all purchases and sales of Western Pacific Railroad Corporation preferred stock; J. S. Farlee & Company, confirmation of all purchases and sales of preferred stock to April 10, 1948; and J. S. Farlee & Company, confirmation of purchases—wait. No, that is part of the same one. And Western Pacific Railroad Corporation preferred stock given by Russell M. Van Kirk to Mrs. Russell M. Van Kirk, and owned and held by her. These documents are offered, as were the similar schedules, with respect to the intervenor Offerman, to which your Honor sustained an objection.

Mr. Clark: And to which we now object, your Honor, upon the same ground, that it is incompetent, irrelevant and immaterial.

Mr. Adams: Now may I say, your Honor will recall at that time we had some argument, and I don't want to repeat it at all, in which reference was made to the Comstock case, among other things. I have since looked at some cases with respect of a right of stockholders to intervene. That is what

these cases specifically are; they come up on motion to intervene, and there is authority, specifically on the proposition that the [1557] courts may hear and consider the investment position, the date year of acquisition and all the factors that are covered in these schedules, because these schedules, as your Honor well knows, are designed to show how late these gentlemen in this company came into this corporation and at what prices. I offer the schedules without imposing duplicate argument upon the Court; but I do think we are entitled to them, as I did think at the time.

Mr. Clark: We will object to them, your Honor, upon the ground it is incompetent, irrelevant and immaterial.

The Court: I will make the same ruling as I did in connection with the other exhibit; 59 for identification.

Mr. Adams: 59 for identification will consist of these three documents, your Honor.

The Court: Very well.

(Railroad Company's Exhibits 795, 796 and 797 on deposition were marked Defendants' Exhibit 59 for identification.)

Mr. Adams: Now, your Honor, I offer the Form 174 Revised, which is one of these monthly operating results, and general statistics, printed papers of the Western Pacific Railroad Company for the month of November, 1943. This is offered for a very limited purpose; the plaintiffs put in Exhibit 74 and 75 with regard to the 1943 income tax accruals,

and I don't remember which of these exhibits it is, or both of them, but they contain estimates of the amount of accrued tax liability [1558] in the amount of about \$8,250,000. Then the record shows that the accruals, as at the end of the year and before they were reversed, amounted to \$7,000,000. So there is an unexplained gap of a million and a half dollars. To meet that unexplained gap between those two papers, I offer this document, which shows that in November estimated back pay accrued on account of wage increase was entered in an amount of nearly a million dollars and had a corresponding effect on the tax accruals. That is the sole purpose, and if counsel will accept my statement, I needn't offer the document.

Mr. Phleger: I will accept the statement.

Mr. Clark: Accepted.

Mr. Adams: Now, then, your Honor, I should like to read from the minutes of a special meeting of the board of directors of the plaintiff corporation held at the residence of Mr. T. M. Schumacher in New York on Wednesday, August 13, 1947, and state the directors that were present at that meeting, who were: Mr. Curry, W. W. Hatton, F. C. Nicodemus, Jr., A. Perry Osborn, T. M. Schumacher, M. C. Valouch, and Willis D. Wood.

Now, at the page marked 103 of the minute book, of the minutes of that meeting, there appears the following:

"The Board considered at length the question of withdrawing the offer of settlement in view of the

fact that the Railroad Company refused to stipulate a withdrawal of its technical defenses. [1559] After full consideration, it was the judgment of the Board that any withdrawal of the offer of settlement would be prejudicial to this corporation and its stockholders."

I think counsel will agree with my further statement that the minutes of the meeting also contain a copy of the stipulation which was thereafter executed, and of counsel's opinion with regard to that stipulation.

Mr. Phleger: I object to it as incompetent, irrelevant and immaterial. It took place long after this suit was filed.

Mr. MacKinnon: The competency is conceded of all these documents.

Mr. Phleger: Yes, you are quite right. There is no objection on the ground of competency, but it is irrelevant and immaterial.

Mr. Adams: The relevance of the portion I read, your Honor, is this—it is relevant on two grounds and in two respects: In one respect, it shows certainly that this independent board of directors seriously considered a refusal to go along with the then pending offer of settlement. It is a curious coincidence that it happened that that was the date that the Commissioner accepted it, but this board didn't know that when it took this action.

Mr. Clark: Didn't know that?

Mr. Adams: It couldn't possibly be known until the [1560] second day.

Mr. Clark: Because the second Krigbaum letter, of course, was known.

Mr. Adams: Counsel of course can make his argument when his time comes, and I should not, perhaps, be arguing, but I was asked to reply to a statement with regard to the relevance of the offer I have just made, and I have stated one ground of relevance.

Now, another ground of relevance is this, your Honor: This is significant of the nature of the claim that is presented here to your Honor. It is significant that here, even at that date, with a settlement available that everyone knew was a very fine settlement to this transaction, these gentlemen, who hadn't a dime in the interest, only a claim in litigation, seriously gave consideration to throwing that settlement overboard unless the defendant corporation would waive the defense of the bar of reorganization.

Now, we think that is significant in this case, and we offer the material I have just read in support of that.

The Court: Well, what is the significance of it? You say you think it is significant?

Mr. Adams: It is significant of the nature of the equity that is brought before your Honor, that is in fact predicated upon a force position.

The Court: You mean that the Court should consider against [1561] the plaintiffs the fact that they were rather forceful about asserting their point?

Mr. Adams: Oh, no, your Honor; the thing they considered doing is the thing that, in my judgment, is indefensible.

The Court: Well, sometimes litigants, with resourceful attorneys, are very successful in holding a heavy cudgel over the heads of their opponents, if they want to get some result out of it. What has that got to do with the essential merits of this? It is just a little atmosphere to the thing that you don't like, because you think they were too tough about it. But that hasn't anything to do with the merits of the controversy itself. I don't see that it has any relevance in the matter.

Mr. Adams: Well, it certainly is material, is it not, your Honor, to establish the fact of the independence of this board of directors, it being still suggested that they were dominated and controlled?

The Court: Well, at that time counsel were here on both sides of the case in my court, presenting these very stipulations for approval, and for an order of court; so they were dealing then at arm's length. There wasn't any question about that. They were in here in court.

Mr. Adams: That is right.

Mr. Clark: In fact, the interveners came in and asked for an injunction on this very thing. [1562]

The Court: I will sustain the objection to the relevancy.

Mr. Adams: Very well, your Honor. I need not offer the document, since the offer I read was all the offer I intended to make.

Now, I have one further document. So I hope that is successful. The document is Railroad Company Defendant's Exhibit 120, and is a copy of the by-laws of the plaintiff corporation as amended to July 28, 1942; and being at the time it was produced, upon the taking of the depositions, the latest amendment. These by-laws describe the functions of the various officers, to which Mr. Curry has had reference from time to time in the course of his testimony.

The Court: Any objection to the by-laws of the corporation?

Mr. Phleger: No.

Mr. Clark: None from us, your Honor.

The Clerk: No. 60.

(Railroad Company Defendant's Exhibit 120, corporation by-laws, was received in evidence and marked Defendants' Exhibit 60.)

* * *

Mr. Matthew: If the Court please, it will take but a moment. I just want to suggest a stipulation that the final [1563] order of March 28, 1946, in the reorganization proceeding was served upon all parties to the reorganization proceeding as well as counsel, and the publication was also made in accordance with the terms of the order. That appears in the record.

Mr. Phleger: Subject to check, that is all right.

Isn't that recited in the final order itself, that notice was given?

Mr. Matthew: Oh, yes, as far as that is con-

cerned. I am talking about service of the final order itself. There is ample evidence—it also appears that the notice of the hearing upon the petition was likewise given in regular course, but I simply want to establish the fact that the final order was served in the regular course.

Mr. Phleger: If you say that it was, we will agree that it was.

Mr. Matthew: I think we need no stipulation to further orders because counsel will agree that they were received in regular course.

Mr. Adams: We rest.

Mr. MacKinnon: The defendant Western Realty Company rests, your Honor.

(Defendants rest.)

Mr. Phleger: The plaintiff will now offer in evidence as Plaintiff's Exhibit 81 the Federal corporation income and declared value excess profits tax return of the defendant [1564] railroad and affiliated companies for the calendar year 1945, and as 81-B the excess profits tax return for the same year, 1945, and as Plaintiff's next exhibit, 82, the corporation income tax return of the Western Pacific Railroad Company and affiliated companies for the calendar year 1946; and as the next exhibit, the corporation income tax return for the Western Pacific Railroad Company and affiliated companies for the calendar year 1947.

(The documents referred to were marked respectively Plaintiff's Exhibits 81-A, 81-B, and 82 and 83.)

The Court: Very well.

Mr. Phleger: The plaintiff rests.

Mr. Clark: Your Honor, we have only one formal matter [1565] on the part of the interveners, and that is according to the record at page 716 I did not get the concession which was agreed on substantially on pre-trial relative to the stock holdings and dates of acquisition of the intervening stockholders. The stipulation I asked for appears at page 716. The record does not indicate that anyone responded except Mr. Adams, who had some qualification of it, so I will now ask for the agreement and the concession I asked for, namely, that the intervener Henry Offerman now owns 4,080 shares of the preferred stock of the plaintiff corporation; that he held 3,903 shares at the time the deposition in this case was taken, and has been a stockholder of the plaintiff since July 7, 1942; that the intervener J. S. Farlee & Company, Inc., is now the owner of 10,000 shares of preferred stock of the plaintiff corporation, and at the time of the depositions—this is in answer to Mr. Adams' suggestion at the time I first asked for this concession—Farlee owned 9,320 shares and had been a stockholder since January 7, 1944; and that Meredith H. Metzger, formerly Meredith H. Van Kirk, who was substituted for her deceased husband by order of this Court on January 28, 1949, is the owner of 11,385 shares of the preferred stock of the plaintiff, 8,200 shares of which were distributed to her from the estate of her deceased husband, and that he had

been a stockholder, that is, Russell M. Van Kirk, of the plaintiff corporation since February 23, 1944. Now, may I have that concession from you, Mr. Phleger? [1566]

Mr. Phleger: Yes.

Mr. Clark: And Mr. MacKinnon?

Mr. MacKinnon: I am looking for the pre-trial minutes because I do not remember what was said. May I see the transcript? I will abide by whatever I agreed to abide by.

Mr. Clark: We offered a stipulation, if your Honor please, at the pre-trial, a written stipulation in which these figures and dates appear. The stipulation contained some other matters, it having been incorporated between Mr. Phleger's office and mine in the one stipulation, and with respect to this stockholders' matters, Mr. MacKinnon and Mr. Adams said that they would take at the trial our statement as to the amount of stock that was held and the dates of acquisition. They have had access to the certificates and opportunity to examine them on deposition. There is no question about the fact at all.

Mr. Adams: Your Honor, as I believe I stated at the pre-trial—and I am speaking from memory—I accept Mr. Clark's statement with regard to the present ownership of the number of shares held, but as I believe I further stated at the pre-trial, no concession on my part or agreement which I have made for the substitution of Mrs. Metzger, formerly Mrs. VanKirk, as a party is to relieve

her from the defenses good as against her husband. That was the understanding. On that understanding I will accept Mr. Clark's statement with regard to the number of shares of stock held by each of the interveners whose names he [1567] has called off.

Mr. Clark: And the dates of acquisition, Mr. Adams? And the dates I gave for the original acquisition?

Mr. Adams: I think they are correct, and I assume they check with the schedule.

Mr. Clark: They do, and I checked them.

Mr. MacKinnon: I will accept whatever I agreed to on pre-trial, your Honor. I have tried but I cannot find what I agreed to. Nobody has the minutes. I am not questioning their stockholdings.

The Court: Let us end it. Will you stipulate that you will accept Mr. Clark's statement subject to check?

Mr. MacKinnon: Certainly, subject to check.

The Court: If we do not hear from you to the contrary, you have agreed to it.

Mr. MacKinnon: Absolutely.

Mr. Clark: The interveners rest, your Honor.

Mr. MacKinnon: At this time I make a motion, as I made a motion at the end of the interveners' case, to dismiss the complaint and I am prepared to argue it at length or to save your Honor's burden of hearing it, whichever you desire, because I think the interveners have failed completely in making any case here, and I say that particularly in view of the reckless charges—the reckless

charges—and I am using the word advisedly, of these interveners with respect to Mr. Coulson, the James [1568] Foundation of New York, because there isn't an iota of evidence of conspiracy which they charge in their complaint. There is not an iota of evidence that the James Foundation of New York dominated or controlled this picture. There is not an iota of evidence that Col. Coulson dominated or controlled the stock situation for his benefit or for the benefit of the James Foundation. Those charges are reckless charges.

The Court: Mr. MacKinnon, you have made the motion. I wonder whether you cannot reserve your argument until we have some discussion and determine generally how this case is going to be submitted.

Mr. MacKinnon: Whatever you please, your Honor.

The Court: Do you gentlemen want to brief this case? I suppose you do. Or do you want to argue it, too? [1569]

* * *

PLAINTIFF'S EXHIBIT No. 6

Claim

To Be Filed With the Collector Where Assessment
Was Made or Tax Paid

The Collector will indicate in the block below the kind of claim filed, and fill in the certificate on the reverse side.

- Refund of Tax Illegally Collected.
 Refund of Amount Paid for Stamps Unused,
in Error or Excess.
 Abatement of Tax Assessed (not applicable to
estate or income taxes).

State of New York

County of New York—ss.

Name of taxpayer or purchaser of stamps, Western
Pacific Railroad Corporation.

Business address: 37 Wall Street, New York 5,
New York.

The deponent, being duly sworn according to law, deposes and says that this statement is made on behalf of the taxpayer named, and that the facts given below are true and complete:

1. District in which return (if any) was filed
2d N. Y.
2. Period (if for income tax, make separate form
for each taxable year) from January 1, 1942,
to December 31, 1942.

3. Character of assessment or tax, Corporation income and declared value excess profits tax.
4. Amount of assessment, \$4,201,821.54; dates of payment 3/15—6/15—9/14—12/15/43.
5. Date stamps were purchased from the Government.....
6. Amount to be refunded, \$4,201,821.54.
7. Amount to be abated (not applicable to income or estate taxes)
8. The time within which this claim may be legally filed expires, under Section 322(b)(1) of the Internal Revenue Code, on March 15, 1946.

The deponent verily believes that this claim should be allowed for the following reasons:

(See statement attached.)

WESTERN PACIFIC RAIL-
ROAD CORPORATION,

/s/ M. J. CURRY,
President.

Sworn to and subscribed before me this 9th day of March, 1945.

MARY C. VALOUCH,
Notary Public, Westchester
County.

Collector's Stamp.

[Stamped]: Received Collector of Internal Revenue, 2nd Dist. of New York, Mar. 9, 1945.

Western Pacific Railroad Corporation
Year 1942

Statement Accompanying Claim for Refund

The taxpayer is entitled, under the provisions of Section 23(s) of the Internal Revenue Code, to a net operating loss deduction in the amount of \$55,093,108.70, computed in accordance with the provisions of Section 122 of the Code. Said net operating loss deduction is the amount of the reported net operating loss for the year 1943, which, in accordance with the provisions of Section 122, is a net operating loss carry-back for years beginning after December 31, 1940.

The details of the facts producing the net operating loss, the net operating loss carry-back and the net operating loss deduction are shown in full on the Federal tax return filed by the taxpayer for the calendar year 1943, which said return and its supporting schedules by this reference are made a part of this claim for refund.

The taxpayer requests the right, at the time this claim is reached for consideration, to file any further additional evidence deemed appropriate in the consideration of this claim, and it is further respectfully requested that before action is taken with respect thereto, an opportunity for hearing be granted the taxpayer.

Wherefore, the taxpayer alleges that it is entitled under the provisions of Section 23(s) of the Code to a net operating loss deduction in the above-stated amount computed under the provisions of Section

122(c) of the Code; that by reason thereof, there is no taxable net income for the year 1942; and that the tax paid for said year in the amount of \$4,201,821.54 constitutes an overpayment, claim for the refund of which, together with interest as provided by law, is hereby made.

[Endorsed]: Filed Feb. 1, 1949.

PLAINTIFF'S EXHIBIT No. 7

In the District Court of the United States, for the
Northern District of California, Southern
Division

No. 265080

THE WESTERN PACIFIC RAILROAD COR-
PORATION,

Plaintiff,

vs.

THE WESTERN PACIFIC RAILROAD COM-
PANY, SACRAMENTO NORTHERN RAIL-
WAY, TIDEWATER SOUTHERN RAIL-
WAY, DEEP CREEK RAILROAD COM-
PANY, THE WESTERN REALTY COM-
PANY, THE STANDARD REALTY AND
DEVELOPMENT COMPANY and DELTA
FINANCE CO., LTD.,

Defendants.

RUSSELL M. VAN KIRK, HENRY OFFER-
MAN and J. S. FARLEE & CO., INC., a Cor-
poration,

Intervenors.

STIPULATION AND AGREEMENT BE-
TWEEN PLAINTIFF AND DEFENDANTS
RELATING TO AGREEMENT WITH THE
BUREAU OF INTERNAL REVENUE

1. The Bureau of Internal Revenue has accepted a proposal for the settlement of corporation income and excess profits tax liability on behalf of the

Plaintiff's Exhibit No. 7—(Continued)

parties hereto, copies of which said proposal and acceptance are annexed hereto marked Exhibit A.

2. It is stipulated and agreed as follows:

(a) That the approval and acceptance of such settlement by the plaintiff and the defendants shall be without prejudice to the interests, claims or defenses asserted by the parties hereto, respectively, in the subject matter of this action and without prejudice to the position of the said parties inter se with respect thereto, and that all the interests and claims asserted by the said parties are to be determined with relation to, and as limited to, the net amount of alleged tax saving involved in this action as diminished by the settlement.

(b) More particularly, the claim for refund of taxes paid for the year 1942 shall not be deemed to have been abandoned by said settlement, but on the contrary said refund claim shall be deemed to have been diminished in the proportion in which the aggregate of the tax savings involved in this action shall have been diminished by the settlement, and as so diminished to have been allowed, paid to the plaintiff as the agent for the affiliated group designated in Regulations 104 and 110, and by the plaintiff paid into court, and the tax savings for the year 1943 and for the first four months of 1944 shall be deemed to have been diminished in like proportion. Nothing herein contained shall obligate any party hereto to make any deposit or payment into court.

(c) By acquiescence in such settlement none of

Plaintiff's Exhibit No. 7—(Continued)

the parties hereto waives any of its interests, claims or defenses in the above-entitled action, as against any other party, but all such interests, claims and defenses shall relate to the amount of tax savings as diminished by said settlement, and all parties stipulate and agree that the aggregate amount of the tax savings involved in or claimed in said action has been diminished by said settlement by the amount of \$4,201,821.54.

(d) Nothing herein contained shall be deemed to be or constitute a recognition or admission on the part of any party of the validity, merit or equity of the claims of any other party to said tax savings as reduced, or to any part thereof, or a waiver, surrender, or relinquishment in any manner or to any extent of the defenses or any thereof of any party to the claims of any other party in and to such tax savings, as reduced.

(e) In the event the said tax liabilities of the parties hereto shall not be finally settled in accordance with said agreement with the Bureau of Internal Revenue, this stipulation shall be of no force or effect whatsoever, and all the parties shall be released herefrom with like effect as if this stipulation had never been made.

Dated September 3, 1947.

/s/ LeROY R. GOODRICH,
/s/ F. C. NICODEMUS, JR.,

Attorneys for Plaintiff, The Western Pacific Railroad Corporation.

Plaintiff's Exhibit No. 7—(Continued)

ALLAN P. MATTHEW,
JAMES D. ADAMS,
ROBERT L. LIPMAN,
BURNHAM ENERSEN,
McCUTCHEON, THOMAS,
MATTHEW, GRIFFITHS &
GREENE,

Attorneys for Defendants, The Western Pacific Railroad Company, Sacramento Northern Railway, Tidewater Southern Railway Company, Delta Finance Co., Ltd., and Standard Realty and Development Company.

PILLSBURY, MADISON &
SUTRO,
FELIX T. SMITH.

EVERETT A. MATHEWS,
WHITMAN, RANSOM,
COULSON & GOETZ.

By EVERETT A. MATHEWS,
Attorneys for Defendant The
Western Realty Company.

Plaintiff's Exhibit No. 7—(Continued)

EXHIBIT A

Whitman, Ransom, Coulson & Goetz
40 Wall Street, New York 5, N. Y.

February 11, 1947
(Copy)

The Honorable Joseph D. Nunan, Jr.,
Commissioner of Internal Revenue
Washington, D. C.

Attention: Mr. Frank Eddingfield

Re: The Western Pacific Railroad Corporation and
Affiliated Corporations

1942, 1943 and 1944 Federal Income Taxes

Dear Sir:

The Western Pacific Railroad Corporation and its affiliated subsidiaries filed consolidated returns for the calendar years 1942 and 1943 and the said Western Pacific Railroad Corporation filed a consolidated return for the calendar year 1944 including therein its said subsidiaries for the period from January 1, 1944, to April 30, 1944, during which period affiliation existed.

On the said return for 1942 a consolidated tax liability of \$4,201,821.54 was reported and duly assessed and paid. On the said return for 1943 there was reported a net loss and no taxable income. On the said return for 1944, based on a carryover of the unused 1943 net loss, there was reported no tax-

Plaintiff's Exhibit No. 7—(Continued)

able income and no tax liability. A claim for refund of the tax so paid for 1942, based on a carryback of the said 1943 net loss, was filed and is now pending in your office.

The taxpayer on behalf of itself and its aforesaid affiliated subsidiaries hereby offers to settle and determine the tax liabilities of the said corporations for the said taxable years 1942, 1943 and 1944 in the amounts shown on the returns filed as aforesaid. This proposal of settlement does not relate to or affect the tax liability of the said subsidiaries from and after April 30, 1944, when their affiliated status with The Western Pacific Railroad Corporation was terminated. The within proposal is made without prejudice to any rights or claims of the parties, if the proposal is not accepted by you.

As part of this proposal The Western Pacific Railroad Corporation, on behalf of itself and its aforesaid affiliated subsidiaries agrees that, if this proposal is accepted, it will consent to a rejection of the said claim for refund of the 1942 taxes and further agrees not to sue upon said claim or file other or further claims in respect of 1942 taxes on any ground whatsoever. It is further agreed by the said The Western Pacific Railroad Corporation on behalf of itself and its aforesaid affiliated subsidiaries that if this proposal is accepted it will execute or procure the execution of any other or further agreements or assurances requested by the Commissioner of Internal Revenue for the purpose of effectuating the settlement.

Plaintiff's Exhibit No. 7—(Continued)

Authority for the submission of the within proposal of settlement by the undersigned is contained in a Power of Attorney heretofore filed in your office.

Respectfully,

THE WESTERN PACIFIC
RAILROAD CORPORATION,

JAMES K. POLK,
Attorney-in-Fact.

EXHIBIT C

Treasury Department
Washington 25

Aug. 13, 1947

The Western Pacific Railroad Corporation
and Affiliated Companies

c/o Mr. James K. Polk
40 Wall Street
New York 5, New York

In re: Years—1942, 1943 and 1944

Gentlemen:

Reference is made to your letter dated February 11, 1947, regarding the examination of income and profits tax returns for the years indicated above.

You are advised that all the administrative action in connection therewith, based upon the record supplied this office by the internal revenue agent in

Plaintiff's Exhibit No. 7—(Continued)
charge, has been completed and the returns placed
in the closed files.

Very truly yours,

/s/ E. I. McLARNEY,

Deputy Commissioner.

EXHIBIT D

Treasury Department
Washington 25

Aug. 26, 1947

The Western Pacific Railroad Corp.
c/o Mr. J. K. Polk
40 Wall Street
New York 5, New York

In re: Claims for refund of \$4,201,821.54
\$7,454.73 and \$161,449.48 for the year
1942

Gentlemen:

In accordance with the provisions of section 3772(a)(2) of the Internal Revenue Code, this notice of disallowance in full of your claim or claims is hereby given by registered mail.

By direction of the Commissioner:

Very truly yours,

/s/ E. I. McLARNEY,

Deputy Commissioner.

[Endorsed]: Filed Sept. 5, 1947.

[Endorsed]: Filed Feb. 1, 1949. (Plaintiff's Ex-
hibit No. 7.)

PLAINTIFF'S EXHIBIT NO. 8

In the Southern Division of the United States District Court for the Northern District of California

No. 26591-S

In the Matter of

THE WESTERN PACIFIC RAILROAD COMPANY,

Debtor.

ORDER APPROVING
PLAN OF REORGANIZATION FOR DEBTOR

These proceedings coming on for hearing on the modified plan of reorganization for the Debtor, approved by the Interstate Commerce Commission in its Report and Order entered June 21, 1939, and certified to this Court by said Commission on September 28, 1939, together with a transcript of the proceedings before said Commission and a copy of its said Report and Order approving said modified plan, and the Court having considered the entire record in these proceedings, including the transcript of the proceedings before said Commission certified to this Court and the evidence adduced and arguments presented at the hearing before this Court on Januray 22 to 25, 1940, and the Court having heretofore on August 15, 1940, filed its opinion herein,

Plaintiff's Exhibit No. 8—(Continued)

The Court Finds:

1. The findings of fact made by the Interstate Commerce Commission in its Original Report of October 10, 1938, as modified by its Supplemental Report of June 21, 1939, are supported by the evidence, and as supplemented by the stipulation of the parties filed herein on December 20, 1939, are adopted as findings by this Court.

2. The Plan of Reorganization, approved by the Report and Order of the Interstate Commerce Commission of June 21, 1939:

(a) Includes provisions modifying and altering the rights of creditors of the Debtor;

(b) Provides for fixed charges (including fixed interest on funded debt, interest on unfunded debt, amortization of discount on funded debt, and rent for leased railroads) in such an amount that, after due consideration of the probable prospective earnings of the property, in light of its earnings experience and all other relevant facts, there should be adequate coverage of such fixed charges by the probable earnings available for the payment thereof;

(c) Provides adequate means for the execution of the Plan; and

(d) In all other respects complies with the provisions of Subsection (b) of Section 77.

Plaintiff's Exhibit No. 8—(Continued)

3. Said Plan of Reorganization.

(a) Is fair and equitable;

(b) Affords due recognition to the rights of each class of creditors and stockholders;

(c) Does not discriminate unfairly in favor of any class of creditors or stockholders;

(d) Will conform to the requirements of the law of the land regarding the participation of the various classes of creditors and stockholders; and

(e) Provides for payment of all costs of administration and all other allowances made or to be made by this Court.

4. By order entered August 15, 1940, this Court fixed the amount to be paid by the Debtor, or any corporation acquiring its assets, for fees and expenses incident to the reorganization through October 31, 1939. Said amounts are reasonable and within maximum limits heretofore fixed by the Interstate Commerce Commission and said order constitutes full disclosure of the approximate amounts to be paid by the Debtor, or such other corporation, for such fees and expenses so far as they could be ascertained at the date of said hearing before this Court on January 22 to 25, 1940. Such additional amount as may be required to be paid by the Debtor or such other corporation for services performed and expenses incurred (includ-

Plaintiff's Exhibit No. 8—(Continued)

ing reasonable attorneys' fees) after October 31, 1939, in connection with the proceeding and plan of reorganization, and in connection with the carry-out of said plan, if the same is finally confirmed, cannot be ascertained at this time, but such amounts will be subject to the approval of this Court within maximum limits hereinafter to be fixed by the Interstate Commerce Commission.

5. By order entered August 20, 1935, this Court divided the creditors and stockholders of the Debtor into classes and the classes of creditors hereinafter referred to are those fixed by said order.

Wherefore, It Is Ordered:

First: The objections to the Plan of Reorganization approved by the Report and Order of the Interstate Commerce Commission of June 21, 1939, and the claims for equitable treatment heretofore filed herein by or on behalf of the Debtor, the Institutional Bondholders Committee, the Trustee under the Debtor's General and Refunding Mortgage, A. C. James Co., Reconstruction Finance Corporation, The Railroad Credit Corporation, The Western Pacific Railroad Corporation and The Western Realty Company are hereby severally overruled and denied.

Second: Said Plan of Reorganization is hereby in all respects approved.

Third: The findings made by the Interstate

Plaintiff's Exhibit No. 8—(Continued)

Commerce Commission that the interests of the following classes of creditors:

- (a) The Debtor's equipment obligations to be assumed by the Reorganized Company, being classes 6, 7, 8 and 9;
- (b) Claims against the Debtor entitled to priority over any mortgage of the Debtor, current liabilities and obligations incurred by the Trustees of the Debtor during this reorganization proceeding, and expenses of reorganization allowed by this Court within the maximum limits fixed by the Interstate Commerce Commission, which shall be paid in cash or assumed by the Reorganized Company, and which are unclassified;
- (c) Executory contracts of the Debtor which have been affirmed or have not been disaffirmed by the Trustees of the Debtor and not terminating prior to the conclusion of this reorganization proceeding which are to be assumed by the Reorganized Company and which are unclassified;
- (d) Executory contracts made by the Trustees of the Debtor with the approval of this Court which by their terms do not terminate at or prior to the conclusion of this reorganization proceeding, which are to be assumed by the Reorganized Company, and which are unclassified; and
- (e) All taxes levied, assessed or accrued

Plaintiff's Exhibit No. 8—(Continued)

against the Debtor or its property or against any subsidiary and remaining unpaid at the date of the confirmation of the plan, which are to be assumed and paid by the Reorganized Company with the same relative priority that they now have with respect to other obligations of the Debtor;

will not be adversely and materially affected by said Plan of Reorganization is hereby affirmed, and said Plan of Reorganization shall not be submitted to any of such classes for acceptance or rejection.

Fourth: The findings of the Interstate Commerce Commission that, at the time of the finding, the interests of unsecured creditors of the Debtor and the equity of the holders of the Debtor's Preferred Stock and the Debtor's Common Stock have no value, and that the holders of such unsecured claims and such shareholders are not entitled to participate in the distribution of new capital securities or other assets of the Debtor under said Plan of Reorganization is hereby affirmed, and said Plan of Reorganization shall not be submitted to said unsecured creditors or shareholders for acceptance or rejection.

Fifth: The only classes of creditors to whom said Plan of Reorganization shall be submitted for acceptance or rejection are:

(a) Class (1)—holders of claims evidenced by The Western Pacific Railroad Company

Plaintiff's Exhibit No. 8—(Continued)

First Mortgage 5% Bonds due March 1, 1946, issued under the First Mortgage of The Western Pacific Railroad Company dated June 26, 1916, and the interest coupons appurtenant thereto;

(b) Class (3)—Debtor's secured promissory notes issued to A. C. James Co., dated March 28, 1932, and May 31, 1932, respectively, bearing interest at the rate of 5% per annum and due March 28, 1935, and May 31, 1935 (respectively, together with the accrued and unpaid interest thereon;

(c) Class (4)—Debtor's secured promissory notes to Reconstruction Finance Corporation, dated March 1, 1932, June 29, 1932, August 1, 1932, August 30, 1932, and March 25, 1933, respectively bearing interest at the rate of 6% per annum, and due March 1, 1935, June 29, 1935, August 1, 1935, August 30, 1935, and March 25, 1936, respectively, together with accrued and unpaid interest thereon:

(d) Class (5)—Debtor's secured promissory notes to The Railroad Credit Corporation, dated June 29, 1932, and March 25, 1933, respectively, bearing interest at the rate provided for in the Marshalling and Distributing Plan, 1931, of The Railroad Credit Corporation, each note payable on demand, together with accrued and unpaid interest thereon.

Plaintiff's Exhibit No. 8—(Continued)

Sixth: T. M. Schumacher and Sidney M. Ehrman, Trustees of the Debtor, be, and they are hereby directed to send a certified copy of this Order and a certified copy of the opinion of this Court filed herein on August 15, 1940, to the Interstate Commerce Commission for use in submitting said Plan of Reorganization hereby approved to the holders of said claims and interests found to be entitled to vote thereon.

Dated: August 15, 1940.

A. F. ST. SURE,
United States District Judge.

[Endorsed]: Filed Feb. 1, 1949.

PLAINTIFF'S EXHIBIT NO. 10

In the District Court of the United States for the
Northern District of California, Southern
Division

No. 26591-S

In Proceedings for the Reorganization of a Railroad

In the Matter of

THE WESTERN PACIFIC RAILROAD COM-
PANY,

Debtor.

**ORDER CONFIRMING PLAN
OF REORGANIZATION**

These proceedings coming on for further hearing
pursuant to the order of this Court entered herein
on September 22, 1943, and upon the notice pro-
vided to be given by said order, for the purpose of
determining whether or not the plan of reorganiza-
tion heretofore approved by the order of this Court
entered herein on August 15, 1940, shall be con-
firmed, and this Court having considered the record
in these proceedings and having heard all parties
in interest desiring to be heard in support of or in
opposition to the confirmation of said plan of re-
organization and being fully advised in the pre-
mises,

The Court Finds:

1. Due notice of said hearing has been given

Plaintiff's Exhibit No. 10—(Continued)

in accordance with said order of this Court entered herein on September 22, 1943.

2. This Court has jurisdiction of the subject matter of these proceedings and of all of the parties in interest.

3. On July 15, 1943, in conformity with subsection (e) of Section 77 of the Bankruptcy Act, as amended, said plan of reorganization was duly submitted by the Interstate Commerce Commission for acceptance or rejection to the creditors of Classes 1, 3, 4 and 5. In view of the findings of the Interstate Commerce Commission contained in its order dated June 21, 1939, in Finance Docket No. 10913, and the findings of this Court contained in said order entered herein on August 15, 1940, submission of said plan of reorganization to any other class of creditors or to any class of stockholders is not necessary under subsection (e) of Section 77 of the Bankruptcy Act, as amended.

4. On September 15, 1943, the Interstate Commerce Commission duly filed herein its certificate dated September 4, 1943, in which it duly certified to the Judge of this Court the results of said submission.

5. Said plan of reorganization has been duly accepted by or on behalf of creditors of each class to which submission is required under subsection (e) of Section 77 of the Bankruptcy Act, as

Plaintiff's Exhibit No. 10—(Continued)
amended, holding more than two thirds in amount
of the total of the allowed claims of such class which
have been reported in said submission as voting
on said plan of reorganization, submission of said
plan of reorganization to any class of stockholders
not being required under said subsection (e), and
such acceptances have not been made or procured
by any means forbidden by law.

6. The United States is not a creditor of the
Debtor on claims for taxes or customs duties, unless
it be on claims for the payment of which said plan
of reorganization duly provides.

7. All requirements for the confirmation of said
plan of reorganization pursuant to Section 77 of
the Bankruptcy Act, as amended, have been duly
complied with, and said plan of reorganization
should be confirmed.

8. This Court has this day filed herein an opinion
containing a statement of the Court's conclusions
and reasons for confirming said plan of reorganization.

9. Article R of said plan of reorganization,
among other things, provides:

"The plan shall be carried out under the supervision
of a reorganization committee consisting of
three persons, all to be approved by the court, who
shall be designated, one by the bondholders committee,
one by the Reconstruction Finance Corporation,

Plaintiff's Exhibit No. 10—(Continued)
and one by the Railroad Credit Corporation and the
A. C. James Company jointly."

In conformity with said Article R, Frederick H. Ecker, Frank C. Wright, and Robert E. Coulson have been duly designated for membership on said reorganization committee, said Frederick H. Ecker having been designated by Frederick H. Ecker, John W. Stedman and Reeve Schley, constituting the Committee representing a Group of Institutional Holders of the First Mortgage Bonds of the Debtor, said Frank C. Wright having been designated by Reconstruction Finance Corporation, and said Robert E. Coulson having been designated by The Railroad Credit Corporation and A. C. James Co. jointly. This Court is satisfied that said Frederick H. Ecker, Frank C. Wright, and Robert E. Coulson should be approved as members of said reorganization committee.

Wherefore, It Is Ordered:

First: Said plan of reorganization heretofore approved by the order of this Court entered herein on August 15, 1940, is hereby confirmed.

Second: The designation of Frederick H. Ecker, Frank C. Wright, and Robert E. Coulson as members of the reorganization committee provided for in Article R of said plan of reorganization is hereby approved. Said reorganization committee shall have the powers of and authority provided for in said plan of reorganization and shall have full

Plaintiff's Exhibit No. 10—(Continued)

power and authority, under and subject to the supervision and control of this Court, to put into effect and carry out said plan of reorganization and the orders of this Court relative thereto, the laws of any State or the decision or order of any State authority to the contrary notwithstanding. This Court hereby reserves the power, subject to the provisions of Section 77 of the Bankruptcy Act, as amended, and said plan of reorganization, further to define, extend, amend, or otherwise change the powers and duties of said reorganization committee and to enter orders approving or disapproving any action on their part. As provided in Article B of said plan of reorganization, the members of said reorganization committee shall not be liable for any action taken by them in good faith or by any person employed by them in good faith, except for their respective individual malfeasance or willful neglect. To the extent necessary to give effect to the provisions of this paragraph, the members of said reorganization committee shall be indemnified and held harmless against any loss or expense, by the Trustees of the properties of the Debtor until the properties of the Debtor shall have been surrendered by said Trustees and thereafter by the Debtor or such other corporation as may acquire said properties pursuant to said plan of reorganization.

Third: Jurisdiction of these proceedings and of all parties in interest is hereby retained for the pur-

Plaintiff's Exhibit No. 10—(Continued)
pose of entering such other and further orders as
this Court may determine to be necessary.

Fourth: As used in this order, the term "parties in interest" shall include the Debtor, all parties to these proceedings, all indenture trustees, and all creditors and stockholders of the Debtor.

Dated: October 11, 1943.

/s/ A. F. ST. SURE,
United States District Judge.

[Endorsed]: Filed Feb. 1, 1949.

PLAINTIFF'S EXHIBIT NO. 11

Agreement by and Between

The Western Pacific Railroad Corporation,
The Chase National Bank of The City of New York,
Central Hanover Bank & Trust Company,
James Foundation of New York, Inc., and
Frederick H. Ecker, Frank C. Wright and Robert
E. Coulson, As the Reorganization Committee
of The Western Pacific Railroad Company.

Dated November 22, 1943.

Agreement by and between The Western Pacific Railroad Corporation, a Delaware Corporation, hereinafter called the "Holding Company," The Chase National Bank of the City of New York,

Plaintiff's Exhibit No. 11—(Continued)

Central Hanover Bank & Trust Company and James Foundation of New York, Inc., hereinafter called collectively the "Secured Creditors," and Frederick H. Ecker, Frank C. Wright and Robert E. Coulson, hereinafter called collectively the "Re-organization Committee,"

Witnesseth:

The Subject Matter of the Agreement

The Holding Company is indebted to each of the Secured Creditors for money loaned upon a promissory note or promissory notes now in default, against each of which notes certain securities were delivered as collateral by the Holding Company. The aggregate of the indebtedness of the Holding Company to all the Secured Creditors for principal and interest, as of September 30, 1943, is \$10,547,-423.85 which is approximately \$5,650,863.00 in excess of the then market value (approximately \$4,896,560.00), of all the collateral then held by the Secured Creditors. Annexed hereto and designated as Schedules A, B and C, respectively, are statements as to the aforesaid indebtedness of the Holding Company to each of the Secured Creditors and the collateral now or heretofore held by the Secured Creditors as security therefor.

The Holding Company desires to secure the release and discharge of its aforesaid indebtedness to each Secured Creditor, principal and interest, in

Plaintiff's Exhibit No. 11—(Continued)

so far as such indebtedness cannot be satisfied by the collateral held by such Secured Creditor (not including as part of such collateral the preferred and common stock of the Railroad Company hereinafter mentioned); and the Secured Creditors severally desire to apply such collateral in satisfaction of the indebtedness, and to secure the release by the Holding Company of any claims it may have arising out of the previous disposition by them of collateral.

The Holding Company owns all of the outstanding preferred and common stock of The Western Pacific Railroad Company, a California corporation (hereinafter called the "Railroad Company"). The Railroad Company is now in reorganization under Section 77 of the Bankruptcy Act, and the plan of reorganization thereof, approved by the Interstate Commerce Commission by its order of June 21, 1939 (hereinafter called the "Plan"), was duly confirmed by order of the United States District Court, Northern District of California, Southern Division, on October 11, 1943. Said preferred and common stock of the Railroad Company was declared to be without equity or value by an express finding of the Interstate Commerce Commission in its said order of June 21, 1939, which finding was duly adopted by the aforesaid Court, and under the Plan said stock is required to be cancelled. The certificates representing said preferred and common stock of the Railroad Company are in the possession

Plaintiff's Exhibit No. 11—(Continued)

of The Chase National Bank of the City of New York, which claims a lien thereon.

Frederick H. Ecker, Frank C. Wright, and Robert E. Coulson are the members of the Reorganization Committee of the Railroad Company, constituted pursuant to subdivision R of the Plan, and approved as such Reorganization Committee by order of the United States District Court, Northern District of California, Southern Division, on October 11, 1943.

Subject to the jurisdiction of the aforesaid Court, the Reorganization Committee is under the duty of determining the method of carrying out the Plan under the supervision of the Committee. Action by the holders of the preferred and common stock of the Railroad Company may become necessary with respect to the various corporate steps incident to carrying out the Plan and making the same effective. The Reorganization Committee is desirous and the Holding Company is willing that the aforesaid stock of the Railroad Company be held at the disposal of the Reorganization Committee for the purpose of carrying out the Plan and making the same effective and that in connection therewith the Holding Company, as the sole stockholder of the Railroad Company, take such action as the Reorganization Committee may from time to time request.

Plaintiff's Exhibit No. 11—(Continued)

Agreements

I.

The Holding Company agrees to assign, set over and transfer to each of the Secured Creditors, severally and respectively, the securities pledged to such Secured Creditor and still held by it as shown by the statement as to the indebtedness to such Secured Creditor annexed hereto (Schedule A, B or C, as the case may be), and the Holding Company also agrees to release to each Secured Creditor, all rights and interests which the Holding Company has, or might claim to have in and to said collateral, including any rights or interests which the Holding Company has or might claim with respect to collateral heretofore sold by such Secured Creditor as shown by the aforesaid statement. Each Secured Creditor agrees to assume such Federal and State stamp taxes, if any, as may be payable with respect to said transfer to it of pledged securities.

Each Secured Creditor agrees to cancel and surrender to the Holding Company the collateral notes held by such Secured Creditor and more specifically described in the statement as to the indebtedness to such Secured Creditor annexed hereto (Schedule A, B or C, as the case may be), and to release and discharge the indebtedness represented by said notes, principal and interest, in full.

Each Secured Creditor consents to the assignment or transfer to the other Secured Creditors and each of them, of the securities to be transferred by the

Plaintiff's Exhibit No. 11—(Continued)

Holding Company to such Secured Creditors, pursuant hereto, and waives any inequalities in connection with the satisfaction of the indebtedness of the Holding Company to the Secured Creditors, respectively, that may result from the carrying out of this agreement.

The agreements herein contained on the part of the Secured Creditors to be performed are several and none of the Secured Creditors shall be liable for the performance by the other Secured Creditors of their respective agreements; nor shall any partnership or joint relationship between said Secured Creditors be construed to flow from the execution of this instrument.

II.

The Holding Company, as the owner of all the outstanding preferred and common stock of the Railroad Company, agrees to cooperate with the Reorganization Committee in carrying out the Plan and making the same effective by whatever method, in conformity with the Plan, the Reorganization Committee may determine upon, and (in furtherance of this general commitment and not in limitation thereof) the Holding Company particularly agrees that (a) upon written request of the Reorganization Committee, the Holding Company will assign, transfer and deliver or cause to be assigned, transferred or delivered to the Reorganization Committee or the nominee or nominees of the Reorganization Committee, all of the preferred and

Plaintiff's Exhibit No. 11—(Continued)

common stock of the Railroad Company, if the aforesaid United States District Court shall determine such assignment and transfer to be necessary or desirable for the purpose of carrying out the Plan or making the same effective; provided, however, that if any Federal or State stock transfer taxes shall lawfully be applicable to such transfer, provision for the payment of such taxes shall be made by the Reorganization Committee and the Holding Company shall not be obligated for the payment thereof; and (b) from time to time until the preferred and common stock of the Railroad Company has been transferred, as aforesaid, or, if no such transfer be made, until such stock is surrendered for cancellation in accordance with the Plan, the Holding Company, upon written request of the Reorganization Committee, will take such action as the owner of the aforesaid stock of the Railroad Company (whether by voting said stock at meetings of stockholders of the Railroad Company or by the execution and delivery of appropriate authorizations, consents or other written instruments) as may be necessary to authorize such corporate action by the Railroad Company (including, without limitation thereto, the amendment of its Articles of Incorporation and By-Laws and the execution and delivery of the mortgages provided for in the Plan), as the Reorganization Committee may deem necessary or convenient for the purpose of carrying out the Plan and making the same effective.

Plaintiff's Exhibit No. 11—(Continued)

Any action taken by the Holding Company, as the owner of the preferred and common stock of the Railroad Company, pursuant to the agreement in this paragraph contained, and the making of any provision by the Reorganization Committee as to the payment of Federal and State stock transfer taxes, if any such taxes shall lawfully be applicable to the above mentioned transfer, are subject to the approval of the United States District Court, Northern District of California, Southern Division, in the proceeding pending in that Court for the reorganization of The Western Pacific Railroad Company (No. 26591-S).

If the finding of the Interstate Commerce Commission that the preferred and common stock of the Railroad Company is without equity or value shall be annulled, set aside or reversed, whether by Act of Congress or otherwise, or if, for any reason, the Plan shall not be carried out, then the Holding Company and each of the Secured Creditors shall be entitled to be restored to the same rights, claims and privileges with respect to such preferred and common stock as existed immediately preceding the execution of this agreement, and this agreement shall not be deemed to affect or prejudice any such rights, claims or privileges and the physical possession of the certificates for said preferred and common stock (provided said certificates shall not theretofore have been surrendered to the reorganized company or its agent for actual cancella-

Plaintiff's Exhibit No. 11—(Continued)
tion) shall be returned to The Chase National Bank
of the City of New York.

Each of the Secured Creditors hereby consents to
the making by the Holding Company of the agree-
ments set forth in this Article II and to any action
taken by the Holding Company in conformity therewith;
and The Chase National Bank of the City of
New York agrees to release and deliver over the
certificates representing the preferred and common
stock of the Railroad Company now in its posses-
sion to the Holding Company when delivery of the
same becomes necessary or appropriate to carry out
said agreements.

III.

The agreements hereinabove contained shall not
be effective until the agreements by the Holding
Company, as owner of the outstanding preferred
and common stock of the Railroad Company, in Ar-
ticle II hereof shall be approved by the requisite
vote of the stockholders of the Holding Company,
pursuant to the provisions of its Certificate of In-
corporation and By-Laws; provided, however, that
the Holding Company agrees to take such action
immediately as may be necessary or appropriate
to secure the requisite approval by vote of its stock-
holders. Performance of the agreements contained
in Article I hereof shall be rendered by the Holding
Company and each Secured Creditor, respectively,
immediately upon such approval by vote of the
stockholders of the Holding Company.

In Witness Whereof, each of the parties hereto

Plaintiff's Exhibit No. 11—(Continued)
has executed this agreement as of the 22nd day
of November, 1943.

**THE WESTERN PACIFIC
RAILROAD CORPORATION,**

By M. J. CURRY,
President.

[Corporate Seal]

Attest:

JOHN F. WIENKEN,
Secretary.

**THE CHASE NATIONAL BANK OF THE
CITY OF NEW YORK,**

By W. ARTHUR GROTZ,
Second Vice Pres.

[Corporate Seal]

Attest:

WM. MOHRMANN,
A. C.

Western Pacific R.R. Company, etc. 1689

CENTRAL HANOVER BANK
& TRUST COMPANY,

By R. G. COOMBE,
Vice-Pres.

[Corporate Seal]

Attest:

C. R. PARKER, JR.,
Ass't. Sec.

Plaintiff's Exhibit No. 11—(Continued)

JAMES FOUNDATION OF
NEW YORK, INC.,

By WILLIAM W. CARMAN,
President.

[Corporate Seal]

Attest:

CHARLES E. ANDREWS,
Asst. Secy.

REORGANIZATION COMMITTEE OF THE
WESTERN PACIFIC RAILROAD COM-
PANY,

F. H. ECKER.

FRANK C. WRIGHT,

ROBERT E. COULSON.

Plaintiff's Exhibit No. 11—(Continued)

State of New York,
County of New York—ss.

On this 24th day of November, 1943, before me personally came M. J. Curry, to me known, who being by me duly sworn, did depose and say that he resides in New Rochelle, N. Y.; that he is President of The Western Pacific Railroad Corporation, one of the corporations described in and which executed the foregoing instrument; that he knows the seal of the said corporation; that the seal affixed to the said instrument is such corporate seal; that it was so affixed by authority of the Board of Directors of the said corporation, and that he signed his name thereto by like authority.

[Notarial Seal]

/s/ MARY C. VALOUCH,
Notary Public,
Westchester County.

Commission expires March 30, 1945.

State of New York,
County of New York—ss.

On this 24th day of November, 1943, before me personally came W. Arthur Grotz, to me known, who being by me duly sworn, did depose and say that he resides in Ridgewood, N. J.; that he is 2nd

Plaintiff's Exhibit No. 11—(Continued)

Vice Pres. of The Chase National Bank of the City of New York, one of the corporations described in and which executed the foregoing instrument; that he knows the seal of the said corporation that the seal affixed to the said instrument is such corporate seal that it was so affixed by authority of the Board of Directors of the said corporation, and that he signed his name thereto by like authority.

[Notarial Seal]

/s/ HENRY P. SCHOERRY,
Notary Public,
Nassau County.

Commission expires March 30, 1944.

State of New York,
County of New York—ss.

On this 24th day of November, 1943, before me personally came R. G. Coombe, to me known, who being by me duly sworn, did depose and say that he resides in Greenwich, Conn.; that he is Vice Pres. of Central Hanover Bank & Trust Company, one of the corporations described in and which executed the foregoing instrument; that he knows the seal of the said corporation; that the seal affixed to the said instrument is such corporate seal; that it was so affixed by authority of the Board of

Plaintiff's Exhibit No. 11—(Continued)
Directors of the said corporation, and that he signed
his name thereto by like authority.

[Notarial Seal]

/s/ DAVID McPHERSON,
Westchester Co. Notary.

Commission expires March 30, 1945.

State of New York,
County of New York—ss.

On this 24th day of November, 1943, before me personally came William W. Carman, to me known, who being by me duly sworn, did depose and say that he resides in Summit, N. J.; that he is President of James Foundation of New York, Inc., one of the corporations described in and which executed the foregoing instrument; that he knows the seal of the said corporation; that the seal affixed to the said instrument is such corporate seal; that it was so affixed by authority of the Trustees of the said corporation, and that he signed his name thereto by like authority.

[Notarial Seal]

/s/ JAMES YUILLE,
Notary Public,
Westchester County.

Commission expires March 30, 1945.

Plaintiff's Exhibit No. 11—(Continued)

State of New York,

County of New York—ss.

On this 23rd day of November, 1943, before me personally came Frederick H. Ecker, to me known and known to me to be the individual described in and who executed the foregoing instrument and acknowledged to me that he executed the same as a member and by the authority of the Reorganization Committee of The Western Pacific Railroad Company.

[Notarial Seal]

/s/ ALBERT V. ZIELFELDT,

Notary Public,

Bronx County.

Commission expires March 30, 1945.

State of New York,

County of New York—ss.

On this 24th day of November, 1943, before me personally came Frank C. Wright, to me known and known to me to be the individual described in and who executed the foregoing instrument and acknowledged to me that he executed the same as a member and by the authority of the Reorganization

Plaintiff's Exhibit No. 11—(Continued)
Committee of The Western Pacific Railroad Company.

[Notarial Seal]

/s/ DORIS C. THOMAS,

Notary Public, Queens Co.

Commission expires March 30, 1945.

State of New York,

County of New York—ss.

On this 23rd day of November, 1943, before me personally came Robert E. Coulson, to me known and known to me to be the individual described in and who executed the foregoing instrument and acknowledged to me that he executed the same as a member and by the authority of the Reorganization Committee of The Western Pacific Railroad Company.

[Notarial Seal]

/s/ BEATRICE C. CUNNINGHAM,

Notary Public,

New York County.

Commission expires March 30, 1944.

Plaintiff's Exhibit No. 11—(Continued)

Schedule A

Collateral Notes Bearing Interest at 5% Per Annum, Executed and Delivered by The Western Pacific Railroad Corporation to The Chase National Bank of the City of New York

Collateral Notes bearing interest at 5% per annum, executed and delivered by The Western Pacific Railroad Corporation to The Chase National Bank of the City of New York :

Date	Amount	Status as of Sept. 30, 1943
May 31, 1932	\$4,186,000.00	\$1,715,689.36
Dec. 8, 1941	4,521.00	4,521.00
Feb. 9, 1942	7,190.20	7,190.20
Mar. 10, 1943	1,642.16	1,642.16
Total principal indebtedness	\$4,199,353.36	\$1,729,042.72
Accrued and unpaid interest to September 30, 1943		1,991,179.90
Additional indebtedness for advances during 1943		1,546.35
Total indebtedness, principal and interest, as of September 30, 1943		\$3,721,768.97
Collateral held by The Chase National Bank of the City of New York, on September 30, 1943, as security for said collateral notes:		Approximate Market Value as of Sept. 30, 1943
The Denver and Rio Grande Western Railroad Company, General Mortgage Sinking Fund, 5% Gold Bonds, due 1955	Face Amount	
	\$2,792,000.00	\$ 153,560.00
The Denver and Rio Grande Western Railroad Company, Refunding and Improvement Mortgage, 6% Gold Bonds, Series A, due 1974		*\$320,000.00
	800,000.00	
	\$3,592,000.00	\$ 473,560.00

Not traded. Estimated by comparison with other bonds of the same Company which receive comparable treatment under the Plan of Reorganization of that Company.

Plaintiff's Exhibit No. 11—(Continued)
Schedule A—(Continued)

Securities sold by The Chase National Bank of the City of New York, prior to September 30, 1943, pursuant to the terms of the aforementioned collateral notes:

	Face Amount	
The Western Pacific Railroad Company, First Mortgage, 5% Gold Bonds, Series A, due 1946	\$4,464,000.00	Sold prior to Sept. 30, 1943
The Denver and Rio Grande Western Railroad Company, General Mortgage Sinking Fund, 5% Gold Bonds, due 1955	959,875.00	"
The Denver and Rio Grande Western Railroad Company, 6% Cumulative Preferred Stock \$100 par value	2,070,000.00	"
	<hr/>	
	\$7,493,875.00	

Schedule B

Statement of Indebtedness of The Western Pacific Railroad Corporation to Central Hanover Bank & Trust Company and of Collateral Previously Held by Central Hanover Bank & Trust Company

Collateral Notes executed and delivered by The Western Pacific Railroad Corporation to Central Hanover Bank & Trust Company:

	Principal Amount	Status as of Sept. 30, 1943
Note, dated May 25, 1932, at 5% on \$675,000 from January 31, 1934 to January 31, 1935, and on \$635,000 from January 31, 1935 to February 1, 1935, and at 4½% on \$635,000 from February 1, 1935 to January 31, 1942, at 4½% on \$623,751.14 from January 31, 1942, payable on demand	\$ 623,751.14	Principal paid by application of Proceeds of sale of collateral
Note, dated Dec. 1, 1941 at 4½%, payable on demand	671.00	"
Note, dated Jan. 30, 1942 at 4½%, payable on demand	1,067.16	"
Total Principal	<hr/>	
	\$ 625,489.30	

Plaintiff's Exhibit No. 11—(Continued)
Schedule B—(Continued)

Collateral sold by Central Hanover
Bank & Trust Company prior to Sept.
30, 1943:

	Face Amount	
The Western Pacific Railroad Company, First Mortgage, 5% Gold Bonds, Se- ries A, due 1946	\$1,242,000.00	Sold prior to Sept. 30, 1943
The Rio Grande Western Railway Com- pany, First Consolidated Mortgage, 4% Gold Bonds, due 1949	364,000.00	"
The Denver & Rio Grande Railroad Company, First Consolidated Mort- gage, 4% Gold Bonds, due 1936	10,000.00	"
Total	\$1,616,000.00	

Summary

otal net proceeds from sale of collat- eral	\$ 726,484.03
otal principal amount of notes	625,489.30
Balance	\$ 100,994.73
ccrued unpaid interest as of March 24, 1943	\$ 269,151.03
alance of proceeds from sale of collat- eral applied to accrued unpaid inter- est	100,994.73
Balance accrued unpaid interest, Sep- tember 30, 1943	\$168,156.30

Plaintiff's Exhibit No. 11—(Continued)

Schedule C

Statement of Indebtedness of The Western Pacific Railroad Corporation to James Foundation of New York, Inc. and of Collateral Held by James Foundation of New York, Inc. as Security Therefor,
As of September 30, 1943

Collateral notes bearing interest at 5% per annum, executed and delivered by The Western Pacific Railroad Corporation to Curtiss Southwestern Company, a Delaware Corporation, in 1931 and 1932, duly assigned and transferred by Curtiss Southwestern Company to the Estate of Arthur Curtiss James and by the Estate of Arthur Curtiss James to James Foundation of New York, Inc.:

Date	Amount	Status as of
July 1, 1931.....	\$1,475,000.00	Sept. 30, 1943
July 27, 1931.....	920,000.00	\$1,475,000.00
Aug. 28, 1931.....	1,100,000.00	920,000.00
Nov. 25, 1931.....	880,000.00	1,100,000.00
Jan. 25, 1932.....	103,850.00	880,000.00

Total principal indebtedness..... \$4,478,850.00 \$4,478,850.00

Accrued and unpaid interest to September 30, 1943

2,156,193.94

Additional indebtedness for advances during 1940, 1941 and 1942

22,454.64

Total indebtedness, principal and interest, as of September 30, 1943

\$6,657,498.58

Collateral held by James Foundation of New York, Inc., on September 30, 1943, as security for said collateral notes:

Face Amount Status as of

The Western Pacific Railroad Company First Mortgage, 5% Gold Bonds, Series A, due 1946

\$5,980,000.00 Sept. 30, 1943

\$4,186,000.00

The Denver and Rio Grande Western Railroad Company, Refunding and Improvement Mortgage, 6% Bonds, Series A, due 1974

200,000.00 *\$80,000.00

The Western Realty Company, Common Stock, 3,005 shares, par value.....

300,500.00 **\$157,000.00

\$6,480,500.00 \$4,423,000.00

* Not traded. Estimated by comparison with other bonds of the same Company which receive comparable treatment under the Plan of Reorganization of that Company.

** Appraised value as of February 15, 1943.

[Endorsed]: Filed Feb. 1, 1949.

PLAINTIFF'S EXHIBIT No. 12

Filed August 23, 1944.

In the District Court of the United States for the Northern District of California, Southern Division.

No. 26591-S

In the Matter of

The Western Pacific Railroad Company,

Debtor.

PETITION OF REORGANIZATION COMMITTEE FOR AN ORDER APPROVING USE OF THE DEBTOR COMPANY IN CARRYING OUT AND MAKING EFFECTIVE THE PLAN, APPROVING PROPOSED AMENDMENTS TO THE ARTICLES OF INCORPORATION AND PROPOSED NEW BY-LAWS OF DEBTOR COMPANY AND APPROVING FORMS OF PREFERRED AND COMMON STOCK CERTIFICATES AND DIRECTING ACTION WITH RESPECT THERETO

Frederick H. Ecker, Frank C. Wright and Robert E. Coulson, being all the members of the Reorganization Committee designated to put into effect and carry out the plan of reorganization of the debtor above named, hereby represent to the Court and petition as follows:

1. The plan of reorganization of the debtor (herein after called "the plan"), confirmed by order of

Plaintiff's Exhibit No. 12—(Continued)

this Court on October 11, 1943, provides in subdivision R that "The plan may be carried out either by revesting the properties formerly of the debtor in the debtor company or by transferring said properties to a new corporation organized for the purpose," and "The method of carrying out the plan shall be determined by the reorganization committee in its discretion," subject to the approval of the Court. Under subdivision R of the plan your petitioners are empowered also to determine, subject to the approval of the Court, the form and, except as otherwise provided in the plan, the provisions of the charter, by-laws and stock certificates of the reorganized company.

2. The debtor company, The Western Pacific Railroad Company, is a corporation already organized and existing under the laws of the State of California, and has certain rights, privileges and franchises in the states of California, Nevada and Utah, and has the record title to the railroad facilities and properties involved in the bankruptcy proceeding; and the use of the debtor company in carrying out the plan will result in substantial economies and will otherwise facilitate the reorganization. After considering all factors, your petitioners have determined, acting on advice of counsel, that the debtor company should be used in carrying out the plan and that a new corporation should not be organized.

3. Pursuant to the petition of the Reorganization Committee filed herein December 1, 1943, the

Plaintiff's Exhibit No. 12—(Continued)

Court on December 17, 1943, entered an order authorizing and directing transfer of the preferred and common stock of the debtor company to the Reorganization Committee, at a time and place to be fixed in the discretion of the Committee by its request in writing to The Western Pacific Railroad Corporation, a Delaware corporation which previously owned such stock, and approving action of the Committee in connection with a certain agreement for securing control of such stock. The transfer by The Western Pacific Railroad Corporation of the preferred and common stock of the debtor company was duly approved by the requisite vote of the stockholders of The Western Pacific Railroad Corporation, pursuant to the provisions of its Certificate of Incorporation and By-laws on April 20, 1944. Thereafter, on the first day of May, 1944, your petitioners, pursuant to said order of December 17, 1943, made request of The Western Pacific Railroad Corporation for the transfer of said stock in accordance with the authorization of its stockholders and on the same date said stock was duly transferred to your petitioners. Said transfer has been made of record on the books of the debtor company, except as to directors' qualifying shares, certificates for which, duly endorsed in blank, are held by the Reorganization Committee, by the issuance of new preferred and common stock certificates to your petitioners.

4. In order that the debtor company may be used in carrying out and making effective the plan, it

Plaintiff's Exhibit No. 12—(Continued)

will be necessary to amend its Articles of Incorporation and to adopt new By-laws to provide for the new preferred and common stock authorized under the plan and for other changes required by said plan. Your petitioners, subject to the approval of the Court, have approved a proposed Certificate of Amendment of the Articles of Incorporation of the debtor company and proposed new By-laws of the debtor company. Copies of said proposed Certificate of Amendment and By-laws in typewritten form are annexed hereto as Exhibits "A" and "B", and are hereby submitted to the Court for approval as to substance and, also, as to form, subject to such minor changes as the Reorganization Committee, upon advice of counsel, may deem advisable.

5. Your petitioners, subject to the approval of the Court, have also approved in draft form the face of a proposed certificate for shares of the Preferred Stock, Series A, provided under the plan, and the face of a proposed certificate for shares of the Common Stock, likewise so provided, copies of which are annexed hereto as Exhibts "C" and "D," respectively, and are hereby submitted to the Court for approval as to substance and general form. Your petitioners have also approved the reproduction, on the reverse side of each of said stock certificates, of the full text of Article VII of the Articles of Incorporation of the debtor company, after amendment, as shown in the proposed Certificate of Amendment; Exhibit "A", annexed hereto. Inasmuch as the re-

Plaintiff's Exhibit No. 12—(Continued)

verse side of each of said stock certificates will include only the usual form of assignment and the text of said Article VII, which is subject to the approval of the Court as a part of said Exhibit "A", it is deemed unnecessary to submit the forms of the reverse sides of said certificates in draft form.

6. Your petitioners propose, in the event the Court approves the exhibits hereto annexed, to take appropriate action, as the record holders of the present preferred and common stock of the debtor company for the adoption of the proposed By-laws for the debtor company and the proposed amendment to its Articles of Incorporation and to arrange for the preparation of new preferred and common stock certificates, in temporary form, if your petitioners shall determine this to be necessary or advisable, and in permanent engraved form. Your petitioners also propose to request the then directors of the debtor company to take such appropriate action as is required of directors in connection with the adoption of said amendments. It is proposed that the adoption of said amendments to the Articles of Incorporation shall be subject to the further order of the Court as to the time of the filing of the Certificate of Amendment with the Secretary of State of California which will be required in order to make the amendments completely effective.

Wherefore, your petitioners pray for the order of this Court:

(a) Approving the determination of your petitioners that the existing debtor company, The West-

Plaintiff's Exhibit No. 12—(Continued)

ern Pacific Railroad Company, be used in carrying out and making effective the plan of reorganization;

(b) Approving the proposed Certificate of Amendment of the Articles of Incorporation of the debtor company, a copy of which in typewritten form is attached hereto as Exhibit "A", as to substance and, also, as to form, subject to such minor changes as the Reorganization Committee, upon advise of counsel, may deem advisable;

(c) Approving the proposed By-laws for the debtor company, a copy of which in typewritten form is attached hereto as "Exhibit B", as to substance and, also, as to form, subject to such minor changes as the Reorganization Committee, upon advice of counsel, may deem advisable;

(d) Approving the substance and the general form of the proposed face of the certificate for shares of Preferred Stock, Series A, which is attached hereto as "Exhibit C";

(e) Approving the substance and the general form of the proposed face of the certificate for shares of common stock, which is attached hereto as "Exhibit D";

(f) Authorizing and directing petitioners, as the Reorganization Committee of the debtor company and as stockholders of record of the debtor company, to take or cause to be taken such action as may be necessary or appropriate for the adoption of said proposed amendments to the Articles of Incorporation and said proposed By-laws of the debtor com-

Plaintiff's Exhibit No. 12—(Continued)

pany, and for the preparation of complete certificates as described herein for the preferred and common stock contemplated under the plan of reorganization, in temporary form if the petitioners shall determine this to be necessary or advisable, and in permanent form;

(g) Authorizing the directors of the debtor company then in office to take such action, as and when requested by the Reorganization Committee, as may be necessary and appropriate in connection with the adoption of said amendments to the Articles of Incorporation.

(h) Granting such other and further relief as may be proper in the premises.

Respectfully submitted,

WHITMAN, RANSOM,
COULSON & GOETZ

PILLSBURY, MADISON
& SUTRO

Counsel for Petitioners.

[Verification omitted in printing]

[Endorsed]: Filed Feb. 1, 1949.

PLAINTIFF'S EXHIBIT No. 13

Filed Sept. 25th, 1944.

In the District Court of the United States for the
Northern District of California, Southern Divi-
sion.

No. 26591-S

In the Matter of
The Western Pacific Railroad Company,
Debtor.

**ORDER APPROVING USE OF THE DEBTOR
COMPANY IN CARRYING OUT AND MAK-
ING EFFECTIVE THE PLAN, APPROV-
ING PROPOSED AMENDMENTS TO THE
ARTICLES OF INCORPORATION AND
PROPOSED NEW BY-LAWS OF DEBTOR
COMPANY AND APPROVING FORMS OF
PREFERRED AND COMMON STOCK CER-
TIFICATES AND DIRECTING ACTION
WITH RESPECT THERETO**

The petition filed August 23, 1944 by Frederick H. Ecker, Frank C. Wright and Robert E. Coulson, the Reorganization Committee designated to put into effect and carry out the plan of reorganization of the debtor above named, for an order approving the use of the debtor company in carrying out and making effective the plan, approving proposed amendments to the articles of incorporation and proposed new by-laws of the debtor company and approving forms of preferred and common stock certificates and di-

Plaintiff's Exhibit No. 13—(Continued)
recting action with respect thereto, duly came on to
be heard and was heard on the 25th day of Septem-
ber, 1944, and has been submitted.

The Court being fully advised in the premises finds
that notice of the hearing upon said petition has been
given as prescribed by the order of this Court, dated
and filed August 23, 1944, and that all of the allega-
tions and representations contained in the petition
are true.

The Court further finds and concludes :

(a) That the corporate existence of the debtor
and its authority to do business in the states of
California, Nevada and Utah has been duly
maintained and preserved and that the preferred
and common stock of the debtor is held of rec-
ord by the petitioners herein so as to make said
company available for use as the reorganized
company in carrying out and making effective
the plan of reorganization;

(b) That the use of the debtor company as
the reorganized company under the plan of re-
organization, as determined and proposed by the
petitioners herein, will result in substantial econ-
omies and otherwise facilitate the reorganiza-
tion and should be approved;

(c) That the proposed Certificate of Amend-
ment of the Articles of Incorporation of the
debtor company and the amendments to said
Articles contained therein are consistent with
the plan of reorganization and appropriate for
its purposes, and should be approved;

Plaintiff's Exhibit No. 13—(Continued)

(d) That the proposed new By-laws of the debtor company are consistent with the plan of reorganization and appropriate for its purposes, and should be approved;

(e) That the proposed forms of certificates for shares of new Preferred Stock, Series A, and shares of new common stock, as described in said petition, to which are attached as exhibits draft forms of the faces of said certificates, are consistent with the plan or reorganization and appropriate for its purposes, and should be approved; and

(f) That the action proposed to be taken by the petitioners herein, as the record holders of the stock of the debtor company and as the Reorganization Committee under the plan of reorganization, and by the directors of said company then in office, should be authorized.

Now, Therefore, it is hereby Ordered, Adjudged and Decreed:

(1) That the use of the existing debtor company in carrying out and making effective the plan of reorganization, as determined and proposed by the petitioners herein, be and hereby is approved;

(2) That the Certificate of Amendment of the Articles of Incorporation of the debtor company and the amendments to said Articles contained

Plaintiff's Exhibit No. 13—(Continued)
therein, being Exhibit A attached to said petition, be and hereby are approved as to the substance and provisions thereof and as to form, subject to such minor changes as the Reorganization Committee, upon advice of counsel, may deem advisable;

(3) That the By-laws for the debtor company, being Exhibit B attached to said petition, be and hereby are approved as to the substance and provisions thereof and as to form, subject to such minor changes as the Reorganization Committee, upon advice of counsel, may deem advisable;

(4) That the form of certificate for shares of Preferred Stock, Series A, being the form described in said petition, the face of which in draft form was submitted therewith as Exhibit C, be and hereby is approved as to the substance and provisions thereof and as to general form, subject to such minor changes as the Reorganization Committee, upon advice of counsel, may deem advisable;

(5) That the form of certificate for shares of common stock, being the form described in said petition, the face of which in draft form was submitted therewith as Exhibit D, be and hereby is approved as to the substance and provisions thereof and as to general form, subject to such minor changes as the Reorganization Committee, upon advice of counsel, may deem advisable;

Plaintiff's Exhibit No. 13—(Continued)

(6) That the petitioners herein, as the Reorganization Committee under the plan of reorganization and the stockholders of record of the debtor company, be and hereby are authorized and directed to take or cause to be taken such action as may be necessary or appropriate for the adoption of the aforesaid amendments to the Articles of Incorporation and new By-laws of the debtor company and for the preparation of complete certificates as described in said petition for the preferred and common stock contemplated under the plan or reorganization, in temporary form if petitioners shall determine these to be necessary or advisable and in permanent form; and

(7) That the directors of the debtor company then in office be and hereby are authorized to take such action as and when requested by the petitioners herein as said Reorganization Committee, as may be necessary or appropriate in connection with the adoption of the aforesaid amendments to the Articles of Incorporation of the debtor company.

Dated, September 25, 1944.

A. F. St. SURE,
District Judge.

[Endorsed]: Filed Feb. 1, 1949.

PLAINTIFF'S EXHIBIT No. 14

[Plaintiff's Exhibit No. 14 is identical to Exhibits 1, "A", "B", "C", "D", "E", and "F" attached to the Answer and Counterclaim of Defendants Western Pacific Railroad Co., et. al. See printed pages 36 to 108 of Volume 1.]

PLAINTIFF'S EXHIBIT No. 15

Whereas, heretofore in a proceeding in the United States District Court for the Northern District of California, Southern Division, for the reorganization of a railroad under Section 77 of the Bankruptcy Act, as amended, entitled "In the Matter of The Western Pacific Railroad Company, Debtor", No. 26591-S, a Plan of Reorganization of The Western Pacific Railroad Company was approved and confirmed, and, pursuant to the provisions of said Plan of Reorganization, an order was entered on September 25, 1944, by said Court approving the use of the said debtor company, The Western Pacific Railroad Company, a corporation organized and existing under the laws of the State of California, as the reorganized company in carrying out said plan;

Whereas, the Interstate Commerce Commission, under date of October 24, 1944, in Docket #10913, made a report and order which, among other things, approved and authorized the assumption by said The Western Pacific Railroad Company of obligations and liabilities as provided in said plan;

Plaintiff's Exhibit No. 15—(Continued)

Whereas, pursuant to said Plan of Reorganization and to the order entered in said proceeding on November 27, 1944, T. M. Schumacher and Sidney M. Ehrman, as Trustees of the property of said The Western Pacific Railroad Company, duly appointed in said proceeding (hereinafter called the "Trustees"), have, by deed dated December 9th, 1944, remised, released, transferred, conveyed and quitclaimed to the undersigned, said The Western Pacific Railroad Company, all of the property, real, personal and mixed, of every kind and nature, vested in, held, possessed, used or controlled by said Trustees;

Now, Therefore, pursuant to the provisions of said order entered November 27, 1944, and in consideration of the said release, transfer and conveyance by the Trustees, the undersigned The Western Pacific Railroad Company, for itself, its successors and assigns, makes this Agreement with said Trustees, for the benefit of said Trustees and of all other parties in interest in the above-entitled proceedings, under which agreement the undersigned does hereby:

1. Assume and agree to perform all contracts, leases and agreements made or entered into by the debtor in possession or by said Trustees and remaining in effect on December 31, 1944, and all contracts, leases and agreements of the debtor in effect on August 2, 1935, either assumed or not disaffirmed by said Trustees, which remain in effect on December 31, 1944, and expenses of reorganization allowed by

Plaintiff's Exhibit No. 15—(Continued)

the Court within the maximum fixed by the Interstate Commerce Commission;

2. Assume any and all outstanding current liabilities and obligations incurred by said Trustees and without limitation thereto, any and all liabilities or obligations of the debtor in possession or said Trustees with respect to claims for personal injury or death, for loss or damage to property and generally any and all liabilities and obligations with respect to claims of any character whether heretofore or hereafter asserted arising out of the possession, use or operation of the debtor's properties by said Trustees, or their conduct of the debtor's business, including liabilities and obligations hereafter arising up to midnight December 31, 1944.

3. Without limitation of the generality of the foregoing agreements in paragraphs 1 and 2 hereof, specifically undertake to defend at its own sole cost and expense all suits and proceedings, of whatsoever character, now or hereafter instituted against the Trustees, or either of them, arising out of the possession, use or operation of the debtor's properties by the Trustees or of their conduct of the debtor's business, and to assume the conduct of all suits and proceedings, of whatsoever character, heretofore or hereafter brought by the Trustees in the discharge of their duties and responsibilities as such, and, generally, to indemnify the Trustees and save them harmless against all expense, liability, loss, judgments, claims and demands arising out of such suits

Plaintiff's Exhibit No. 15—(Continued)
or proceedings. It is the intent of the covenants in this paragraph 3 contained that The Western Pacific Railroad Company shall assume responsibility for all such suits and proceedings to which the Trustees, or either of them, are or shall become parties, to the same effect as if The Western Pacific Railroad Company instead of the Trustees had been party thereto in the first instance.

4. Without limitation of the generality of the foregoing agreements in Paragraphs 1 and 2 above, specifically assume and agree to perform the obligations of the Trustees in respect of the following:

(a) \$1,235,000 unpaid balance, principal amount of Three Per Cent. Equipment Trust Certificates, Series of 1937, issued February 1, 1937, under Agreement of same date, between J. T. Harrigan and F. E. Egly, Vendors, with Central Hanover Bank and Trust Company, Trustee, and T. M. Schumacher and Sidney M. Ehrman, Trustees of the Property of The Western Pacific Railroad Company, Debtor.

(b) \$1,855,000 unpaid balance, principal amount of One and Three Quarters Per Cent Equipment Trust Certificates, Series of 1941, issued August 1, 1941, under Agreement of same date, between M. J. Suydam and F. W. Walter, Vendors, with Central Hanover Bank and Trust Company, Trustee, and T. M. Schumacher and Sidney M. Ehrman, Trustees of the Property of The Western Pacific Railroad Company, Debtor.

(c) Conditional Sale Agreement, dated as of

Plaintiff's Exhibit No. 15—(Continued)

May 25, 1943, between Lima Locomotive Works, Incorporated, and T. M. Schumacher and Sidney M. Ehrman, Trustees of the Property of The Western Pacific Railroad Company, Debtor, relating to the purchase on monthly installment plan of six steam freight locomotives.

(d) Conditional Sale Agreement, dated as of June 21, 1943, between Electro-Motive Division, General Motors Corporation and T. M. Schumacher and Sidney M. Ehrman, Trustees of the Property of The Western Pacific Railroad Company, Debtor, relating to the purchase on monthly installment plan of three 5400 H. P. diesel electric freight locomotives.

(e) Conditional Sale Agreement, dated as of June 1, 1944, between The Chase National Bank of the City of New York and T. M. Schumacher and Sidney M. Ehrman, Trustees of the Property of The Western Pacific Railroad Company, Debtor, relating to the purchase on monthly installment plan of six 5400 H. P. diesel electric freight locomotives.

5. Without limitation of the generality of the foregoing agreements in Paragraphs 1 and 2 above, specifically assume and agree to pay in cash the face amount of any and all outstanding first mortgage bond coupons which matured on or prior to September 1, 1933, and had not theretofore been presented for payment; such coupons being those which the Court by orders of March 11, 1936 and March 20,

Plaintiff's Exhibit No. 15—(Continued)

1936, authorized The Chase National Bank of the City of New York to pay from funds which had been deposited with it by the debtor:

6. Without limitation of the generality of the foregoing agreements in Paragraphs 1 and 2 above, assume the liability for, and pay in due course, any and all taxes lawfully due to the United States from the debtor or the debtor's Trustees for any taxable period prior to January 1, 1945, whether or not proof thereof was made in the said proceeding and without prejudice by reason of such proof not having been made.

This agreement shall become effective on December 29, 1944, at 12:01 A. M., Pacific War Time.

In Witness Whereof, the undersigned has caused this instrument to be executed in its behalf by its President and its corporate seal to be hereunto affixed this 14th day of December, 1944.

THE WESTERN PACIFIC
RAILROAD COMPANY,

[Corporate Seal] By CHARLES ELSEY,
President.

Attest:

C. L. DROIT,
Secretary.

[Endorsed]: Filed Feb. 1, 1949.

THE WESTERN PACIFIC RAILWAY CORPORATION
Schedule of Preferred and Common Stockholders of Record
September 11, 1935 -- September 16, 1947

333

C = Common Shares
P = Preferred Shares

Source: Certified List of Common and Preferred Stockholders
prepared by Transfer Agent of The Western Pacific
Railroad Corporation for use at stockholders' meetings

REPORT NO. 11
2650829
Officer 17-
FILED FEB 1 1919.
OCTOBER 10
John G. Thompson
DEPARTMENT OF JUSTICE
Reference [initials] ✓
2650829 F.C.

PLAINTIFF'S EXHIBIT No. 18

No. 1

Securities of Western Pacific Railroad Company

Owned by	1935	1936	1937	1938	1939	1940	1941	1942	1943	1944	1945	1946	1947
1st Mortgage 5% Bonds due 1946													
Arthur Curtiss James	\$148,000	\$647,000	\$2,384,000	\$2,964,000	\$3,000,000	\$3,000,000							
Curtiss Southwestern Company	14,000	14,000	14,000	14,000	14,000	14,000							
Curtiss Southwestern Corporation					1,000,000	1,000,000	\$1,000,000	\$1,000,000					
A. C. James Co.						None							
Estate of Arthur Curtiss James							3,014,000	3,014,000					
James Foundation of New York Inc.									\$2,880,000	\$8,860,000			Exchanged for new securities 12/29/44
3 Year 5% Collateral Notes													
A. C. James Co.	\$4,999,800	\$4,999,800	\$4,999,800	\$4,999,800	\$4,999,800	\$4,999,800	\$4,999,800	\$4,999,800	\$4,999,800	\$4,999,800	\$4,999,800	\$4,999,800	
Collateralized by :-													Exchanged for new securities 12/29/44
\$6,249,500 W.P.R.R. Co. 5% Genl. & Ref. Bonds due 1957													
Less 2,000,000 Delivered to Railroad Credit Corp. 3/24/33 on which A.C.J. Co. held second lien													
	<u>\$4,249,500</u>												
4½% Income Mortgage (Convertible) Bonds due 2014													
James Foundation of New York Inc.											\$3,544,000		
A. C. James Co.											163,680		
5% Preferred Stock													
James Foundation of New York Inc.											\$53,160	\$55,727	\$55,727
A. C. James Co.											2,567		
Common Stock													
James Foundation of New York Inc.											\$41,376 1/5	\$153,165 1/5	\$153,165 1/5
A. C. James Co.											37,635		

[Endorsed]: Filed Feb. 1, 1949.

PLAINTIFF'S EXHIBIT No. 22

The Western Pacific Railroad Corporation
 Schedule of Directors
 August 1, 1935 to February 9, 1948

Name	8/1/35	1936	1937	1938	1939	1940	1941	1942	1943	1944	1945	1946	1947	2/9/48
R. S. Brewster	X	R-11/17/36												
T. M. Schumacher	X	X	X	X	X	X	X	X	X	X	X	X	X	X
A. C. James	X	X	X	X		R-12/31/39								
E. H. Ferry	X	R-10/6/36								D-9/7/42				
W. M. Kingsley	X	X	X	X	X	X	X							
W. W. Carman	X	X	X	X	X	X	X			R-2/1/42				
M. J. Curry	X	X	X	X	X	X	X		X	X	X	X	X	X
A. W. Loasby	X	D-11/24/36												
F. J. Shepard	X	X	X	X	X	X	X			D-8/22/42				
R. E. Coulson	X	X	X	X	X	X	X			R-2/6/42				
A. Berger	X	X	X	X	X		D-4/11/40							
W. D. Wood	X	X	X	X	X	X	X	X	X	X	X	X	X	X
J. K. Olyphant, Jr.		E-1/7/37	X	X	X		R-12/18/41							
A. P. Osborn		E-1/7/37	X	X	X	X	X	X	X	X	X	X	X	X
R. M. Price		E-1/7/37	X	X	X	X	D-4/7/41							
H. B. Campbell			E-7/5/40	X	X	X	X	X	X		R-5/1/45			
J. F. Wienken							E-4/29/42	X	X		X		R-4/25/46	
W. W. Hatton							E-9/23/42	X	X		X		X	X
C. C. Sheehan											E-2/15/44	X	R-10/10/46	
M. C. Valoueh												E-5/1/45	X	X
F. C. Nicodemus, Jr.												E-10/10/46	X	X

E—Elected
 R—Resigned
 D—Deceased

[Endorsed]: Filed Feb. 2, 1949.

PLAINTIFF'S EXHIBIT No. 23

The Western Pacific Railroad Corporation
 Schedule of Payments Made to Officers, Counsel and Employees
 August 1, 1935 to December 31, 1946

Name	Aug. 1, 1935- 12/31/35	1936	1937	1938	1939	1940	1941	1942	1943	1944	1945	1946
T. M. Schumacher, President	\$10,416.65	\$25,000.00	\$25,000.00	\$25,000.00	\$15,000.00	\$15,000.00	\$15,000.00					
M. J. Curry, President-Treasurer....											\$4,125.00	\$1,875.00
M. J. Curry, Secretary-Treasurer....	2,250.00	5,400.00	5,400.00	5,400.00	3,300.00	3,300.00	3,300.00	275.00				
M. J. Curry—Expenses	225.68	531.08	433.47	353.92	378.28	366.21	216.13	7.85	47.96	\$115.83	\$ 78.19	\$ 79.15
H. Brua Campbell, Counsel*.....	2,083.30	5,000.00	5,000.00	5,000.00	5,000.00	5,000.00	5,000.00	2,500.00	1,041.65			6,000.00
H. Brua Campbell, Counsel—exp.*												1,935.82
John F. Wienken, Secretary					87.50	525.00	525.00	43.75	916.63	416.65		
John F. Wienken												250.00
C. E. Andrews.....	1,083.30	2,600.00	2,600.00	2,600.00	741.84							
W. C. Mittelberg.....	937.50	2,250.00	2,250.00	2,250.00	920.00							
J. M. Pugh.....					358.17	750.00	750.00					
M. C. Valoueuh.....	312.50	750.00	810.00	810.00	340.00	340.00	340.00	340.00	340.00	141.65		
Lillian O'Neill					260.00	260.00	260.00	260.00	260.00	108.30		
C. C. Sheehan	250.00	600.00	660.00	660.00	240.00	240.00	240.00	240.00	240.00	100.00		
Thomas Keeley (D&RGW reorg.)						112.62						
Whitman, Ransom, Coulson & Goetz (tax matter)				1,335.96								
Sloss & Turner (WP RR reorg.)....							431.35		62.20			
W. V. Hodges (D&RGW reorg.)....								750.00	750.00			
Leroy Goodrich										428.40	3,000.00	
Marshall, All, Carey & Donb.....												6,000.00

* Payments made to Pierce & Greer and F. C. Nicodemus, Jr. included in this item.

[Endorsed]: Filed Feb. 2, 1949.

PLAINTIFF'S EXHIBIT No. 24

The Western Pacific Railroad Corporation
 Schedule of Payments Made to Pierce and Greer,
 or H. Brua Campbell

January 1, 1942 — December 31, 1945

1942

February	Services for January, 1942	\$ 208.33
February	Services for February, 1942	208.33
March	Services for March, 1942.....	208.33
April	Services for April, 1942	208.33
May	Services for May, 1942	208.33
June	Services for June, 1942	208.33
July	Services for July, 1942	208.33
August	Services for August, 1942	208.33
September	Services for September, 1942	208.33
October	Services for October, 1942	208.33
November	Services for November, 1942	208.33
December	Services for December, 1942	208.33
	Total	\$2,499.96

1943

January	Services for January, 1943	\$ 208.33
October	Services for February—May 1943, incl.	833.33
		\$1,041.66

1944

None

1945

August	Expenditures re : reorganization proceedings.....	\$1,935.82
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PLAINTIFF'S EXHIBIT No. 26

The Western Pacific Railroad Company

Ballot
(For straight voting)

Special Meeting of Stockholders, March 26, 1945.

The undersigned hereby vote(s) 134,738 shares of stock for the following-named persons to serve as directors until the annual meeting of stockholders:

Wakefield Baker	J. A. Folger
Edward H. Bell	Harry C. Hagerty
Edward G. Buckland	Charles B. Henderson
J. Reuben Clark, Jr.	J. W. Mailliard, Jr.
Robert E. Coulson	E. W. Mason
Charles Elsey	

Proxies filed

JAMES FOUNDATION OF
NEW YORK, INC.,

A. C. JAMES CO.

By /s/ ROBERT E. COULSON
ROBERT E. COULSON
Proxy or Proxies.

Note: If a stockholder votes personally, his signature must be placed on the first line. If the ballot is cast by proxy or proxies, the name of the stockholder must be signed on the first line and the name(s) of the proxy or proxies on the next line or lines. If several stockholders are represented by proxy or proxies, such proxy or proxies may write

“Proxies filed” on the first line and sign on the next line or lines.

The Western Pacific Railroad Company
Ballot
(For straight voting)

Annual Meeting of Stockholders, June 27, 1945.

The undersigned hereby vote(s) 134,738 shares of stock for the following-named persons to serve as directors until the next annual meeting of stockholders:

Wakefield Baker	J. A. Folger
Edward H. Bell	Harry C. Hagerty
Edward G. Buckland	Charles B. Henderson
J. Reuben Clark, Jr.	J. W. Mailliard, Jr.
Robert E. Coulson	E. W. Mason
Charles Elsey	

Proxies filed

JAMES FOUNDATION
OF NEW YORK, INC.

A. C. JAMES CO.

By /s/ ROBERT E. COULSON
Proxy or Proxies.

Note: If a stockholder votes personally, his signature must be placed on the first line. If the ballot is cast by proxy or proxies, the name of the stock holder must be signed on the first line and the name(s) of the proxy or proxies on the next line o

lines. If several stockholders are represented by proxy or proxies, such proxy or proxies may write "Proxies filed" on the first line and sign on the next line or lines.

The Western Pacific Railroad Company

Ballot
(For straight voting)

Annual Meeting of Stockholders, June 26, 1946.

The undersigned hereby vote(s) 208,892 shares of stock for the following-named persons to serve as directors until the next annual meeting of stockholders:

Wakefield Baker	Harry C. Hagerty
Edward H. Bell	Charles B. Henderson
J. Reuben Clark, Jr.	Stuart Jenkins
Robert E. Coulson	J. W. Mailliard, Jr.
Charles Elsey	E. W. Mason
James A. Folger	

Proxies filed

JAMES FOUNDATION OF
NEW YORK, INC.

By /s/ ROBERT E. COULSON
Proxy or Proxies.

Note: If a stockholder votes personally, his signature must be placed on the first line. If the ballot is cast by proxy or proxies, the name of the stockholder must be signed on the first line and the name(s) of the proxy or proxies on the next line or

lines. If several stockholders are represented by proxy or proxies, such proxy or proxies may write "Proxies filed" on the first line and sign on the next line or lines.

The Western Pacific Railroad Company

Ballot

(For straight voting)

Annual Meeting of Stockholders, June 25, 1947.

The undersigned hereby vote(s) 208,892 shares of stock for the following-named persons to serve as directors until the next annual meeting of stockholders:

Wakefield Baker
Edward H. Bell
J. Reuben Clark, Jr.
Robert E. Coulson
Charles Elsey
James A. Folger

Harry C. Hagerty
Charles B. Henderson
Stuart Jenkins
J. W. Mailliard, Jr.
H. A. Mitchell

Proxies filed from

JAMES FOUNDATION OF
NEW YORK, INC.

By /s/ ROBERT E. COULSON and
STUART JENKINS,
Proxy or Proxies.

Note: If a stockholder votes personally, his signature must be placed on the first line. If the ballot is cast by proxy or proxies, the name of the stockholder must be signed on the first line and the name(s) of the proxy or proxies on the next line or

lines. If several stockholders are represented by proxy or proxies, such proxy or proxies may write "Proxies filed" on the first line and sign on the next line or lines.

[Endorsed]: Filed Feb. 2, 1949.

PLAINTIFF'S EXHIBIT No. 27

Statement No. 1

Sheet 4 of 4 Sheets

Summary

Statements of M. J. Curry, Asst. Treas. Covering Balances, Receipts and Expenditures of W.P. RR. Co. Funds by New York Office for Period—March 15, 1943, to May 1, 1945

	Balances and Receipts
On hand Mar. 1, 1943	\$ 2,224.96
Received Mar. 16, 1943, to Dec. 17, 1943....	40,700.00
	\$ 42,924.96
Received Jan. 14, 1944, to Dec. 19, 1944....	50,800.00
Received Jan. 22, 1945, to Apr. 19, 1945....	14,500.00
Receipts other than W.P. RR. Co. Remittances	348.85
Total Balance and Receipts	<hr/> \$108,573.81

Disbursements

Expended March to Dec. 1943	\$40,836.11
Expended January to Dec. 1944	51,474.69
Expended January to May 1945	14,872.82
Total Expended by M. J. Curry	<hr/> \$107,183.62

Unexpended Balance Returned to E. C. Bates, Treas., June 1945.....	\$ 1,390.19
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Office of General Auditor
San Francisco, California
March 31, 1948

[Endorsed]: Filed Feb. 2, 1949.

PERIOD MARCH 1, 1942 TO MAY 1, 1942

1730

Exhibit 1-42

Mr. J. CURRY, ASST. TREAS.
 Statement of Funds on hand and received: Bal. on hand March 1, 1942
 Disbursements:
 ✓ Remittances to S. J. Curry, San Francisco to Mr. J. Curry, Asst. Treas.
 ✓ New York City - Items remitted
 ✓ Payment of Losses
 Collections from Individuals and Companies for transfers and exchanges
 of W.P.R.R. Co. First Mortgage Bonds
 Total on hand and received by Mr. J. Curry - Mar. 1, 1942 to Dec. 31, 1943
 \$160.00
 \$63,076.88

THE MONTHLY STATEMENT OF M. J. CURRY, ASST. TREAS. COVERING DISBURSEMENTS
BY NEW YORK OFFICE

MARCH	APRIL	MAY	JUNE	JULY	AUGUST	SEPTEMBER OCTOBER	NOVEMBER	DECEMBER	TOTAL
(1)									
\$2,634.98									\$ 2,626.85
3-15-42	4-15-42	5-21-42	6-24-42	7-15-42	8-15-42	9-15-42	10-15-42	11-15-42	12-15-42
3,000.00	3,000.00	4,000.00	4,800.00	4,600.00	4,800.00	4,600.00	4,000.00	4,600.00	8,000.00
									40,700.00
									160.00
									\$63,076.88
✓ NEW YORK OFFICE									
Mr. S. J. Schumacher - Salary									
✓ Expenses									
Mr. J. J. Curry - Salary									
✓ Expenses									
Mr. Wm. Campbell - Salary									
✓ Expenses									
Mary C. Valence - Salary									
✓ Expenses									
J. F. Wiesen - Salary									
Lillian O'Neil - Salary									
✓ Expenses									
De P. K. G. Co. - Staffs									
Albert Goldstein - Postage									
✓ Insurance - Life & Health Fidelity Bond - Mr. J. Curry									
Telephone Expenses - W.P.R.R. Corp.									
Chase National Bank - Office Rent									
Electrician - Electricity									
Hygiene Phone Service									
Central Hanover S. & Co. - Paying Int.									
✓ Mortuary - Cremation Coupons									
S. S. Teleprinters Expenses									
Goldsmith Bros. - Staffs									
Spaless Towel Sup. Co. - Towels									
Sup. Long Water Co. - Water									
United Hand & Supply Co. - Advertising Goods									
United Serv. Corp. - Corp. - Staffs									
W. E. Horner & Co. - Staffs									
Pierrepont & Co. - Expenses									
Std. & Poor's Corp. S.A.S. Securities Service									
Washington Hand & Supply Co.									
Watson's Pub. Co. - Official Guide									
Langdon Co. - Photostats									
New York Telephone Co. - Service									
Long Island Service - Mailing Service									
Holiday Express Agency									
Chase Natl. Bank - Services Eq. Tr. 6/1/29									
Flameless Warehouses - Ware. Rent									
Holy Typewriter Co. - Equip. Repair									
Simonds-Roehman Pub. Co. - Pub. Ry. Age									
Royal Typewriter Co. - Ribbon									
Tele. Co. - Cables - Subscriptions									
Moody's Investors Service									
City Bus Lines - Occupancy Tax									
Lyndhurst House - Montgomery Co.-P.A. Services									
Mr. S. J. Curry - Personal - advertising									
New York Times									
✓ S. J. Morris Co. - Subscription Who's Who									
✓ S. J. Morris Co. - Govt. Manual, etc.									
✓ S. J. Morris Co. - Business Supplies									
Wall Street Journal - Subscription									
Mr. H. H. P. Pub. Co. - Pocket List of Officials									
Addressograph Division - Photo Copyery									
✓ Equip. Repair									
Trans. of U.S.A. - Reorganization Expenses									
Traffic Service - Postage - Subscriptions									
Christmas Contribution to Side. Employees									
TOTAL									
Less Taxes included in salary payments above, withheld and paid to U. S. Treasury									
✓ Federal Income Tax									
Gross disbursements by Mr. J. Curry									
Less amounts included in above disbursements, recovered by Mr. J. Curry, as follows:									
Bank of America - Office rent covering space for transfer Agent, commanding									
Fence 1, 1942 \$ 6,000 per Month									
✓ Sound of deposit at U.S. Post Office as guarantee of postage due on business reply envelope									
Telephone bills chargeable to other individuals									
Withheld by Mr. J. Curry									
Mr. J. Curry, Asst. Treas. Statement Bal. on hand Dec. 31, 1942									
✓ S. J. Curry, Asst. Treas. Statement Bal. on hand Mar. 1, 1943									
(A) Total expenditures for month of March 1943 are inseparable as to periods, Mar. 1 to 15 and Mar. 15 to 31,									
(B) Disbursements made by check, drawn on S. J. Morris Co. Funds in Bank of California, San Francisco, in favor of Mr. J. Curry, Asst. Treas., and transmitted by U.S. Mail to Mr. J. Curry, for deposit to credit of S. J. Morris Co. with Chase National Bank of New York.									

THE UNION PACIFIC RAILROAD COMPANY

STATEMENT NO. A
MAY 1946STATEMENT SHOWING FUNDS SUPPLIED BY THE WESTERN PACIFIC RAILROAD COMPANY TO MR. W. J. CURRY, ASSISTANT TREASURER,
FOR USE IN MAINTAINING THE EXPENSES OF HIS NEW YORK OFFICE AND A DETAIL OF EXPENDITURES MADE FROM SUCH FUNDS BY MR. CURRY.

1702

PERIOD MARCH 15, 1946 TO MAY 1, 1946

YEAR 1946

MR. W. J. CURRY, ASST. TREAS. STATEMENT OF
PURCHASED EXPENSES

	JANUARY	FEBRUARY	MARCH	APRIL	MAY (A)	TOTALS
W.P.R.R. Co. Fund Accts. 1, 1946	\$1,763.01					\$ 1,763.01
(a) Remittances - W. C. Bates, Treas., San Francisco, to Mr. J. Curry, Asst. Treas., New York	1-28-45	2-21-45	3-19-45	4-19-45		
On Demand Account	4,000.00	3,600.00	3,600.00	3,600.00	-	14,800.00
Amount of Remittance						
Total Rec'd. by W. J. Curry, 1946						\$19,563.01

FEE DETAILED FROM MONTHLY STATEMENTS OF W. J. CURRY,
ASST. TREAS. COVERING HIS OFFICE DISBURSEMENTS

T. E. Schaeffer	Salary	1,880.00	1,880.00	1,250.00	1,880.00	\$ 6,000.00
	- Expenses	87.00	347.00	87.00	131.76	566.76
Mr. J. Curry	- Salary	978.00	978.00	978.00	-	3,900.00
J. P. Weinkins	- Salary	978.00	978.00	978.00	-	3,900.00
Mary O. Yelouch	- Salary	239.35	336.35	239.35	-	963.44
Lillian O'Neill	- Expenses	-	66.00	21.00	-	90.00
Charles H. Johnson	- Salary	183.35	183.35	183.35	-	733.35
Chicago National Bank	- Office Rent	406.67	406.67	406.67	405.67	1,628.55
	- Electricity	35.93	40.06	36.91	45.44	152.44
Travelling World	- Postage	3.75	-	-	-	3.75
Oakland Bros.	- Stationery	4.86	9.74	-	2.60	24.18
G. J. Brewer & Co.	- Stationery	8.28	7.43	9.43	3.19	16.27
Sygenic Phone Service	- Services	2.10	8.10	9.10	8.10	18.30
Cryer & Associates Co.	- Tax	1.78	9.10	9.78	8.78	30.25
Feeless Towel Supply Co.	- Towels	17.60	8.30	8.50	8.30	60.80
Western Union Telegraph Co.	- Services	4.09	-	3.00	4.09	16.15
New York Telephone Co.	- Services	80.79	80.73	81.18	75.85	344.81
Allied Telephone Co.	- Services	80.00	-	80.00	25.00	100.00
Standard & Poor's Corp.	- Services	46.45	-	-	-	46.45
Pioneer Warehouses	- Rent	48.00	-	-	48.00	84.00
Commerce Clearing House	- Tax Service	80.90	-	-	-	80.90
United States Steel Corp.	- Stationery	-	9.09	4.55	4.55	16.15
Hoover-Earley Co.	- Stationery	-	3.75	-	-	3.75
Wall St. Ry. Publ. Co.	- Stationery	-	3.75	-	-	3.75
A. S. Barnes & Co.	- Books & Guide	-	10.86	-	-	10.86
The Signature Co.	- Books	-	800.00	-	90.00	280.00
Central Hanover Bank & Trust Co.	- Services Paying Interest	-	95.90	-	-	95.90
Stock Exchange	- Gasoline	-	-	-	10.30	10.30
Langston, Inc.	- Photostats	-	-	115.14	-	115.14
Wall Street Journal	- Subscription	-	5.00	-	-	5.00
Associated Mach. & Equip. Co.	- Subscriptions	-	1.00	-	-	1.00
State Engineers & Mill	- Fid. Bond-W. J. Curry	-	12.00	-	-	12.00
Rand McNally & Co.	- Guide	-	-	30.90	-	30.90
Langton Co., Inc.	- Stationery	-	-	8.83	.75	9.18

TOTALS

\$3,963.00 \$2,990.00 \$2,191.65 \$2,787.32 \$745.30 \$19,563.01

Less Taxes included in above, withheld and paid by

W.P.R.R. Co., San Francisco:

Railroad Retirement Tax

Federal Income Tax

Gross Disbursements by W. J. Curry

Less Fees of Office, rental paid by

W.P.R.R. RR @ \$75.00 per month

Less Collections from individuals for

personnel telephone tolls

Net disbursed by W. J. Curry, 1946

W. J. Curry - Asst. Treas. Bal. at 6-31-45

Rec'd. by Treas. W. C. Bates - San Francisco,
from Asst. Treas. W. J. Curry, New York, June 1946

\$ 151.80 1,863.00 1,378.00

\$15,252.78

375.00

4.93

\$14,676.88

\$1,300.18

NOTE: (A) Expenditures shown above for May 1946, cover expense of maintaining New York Office
for purpose of paying bills incurred prior thereto and closing office.(B) Remittances made by check, drawn on W.P.R.R. Co. funds in bank of California, San
Francisco, in favor of W. J. Curry, Asst. Treas. and transmitted by U. S. Mail to
W. J. Curry for deposit to credit or W.P.R.R. RR with Chase Nat'l. Bank of City of
New York.

STATEMENT SHOWING ALL PAYMENTS MADE BY THE WESTERN PACIFIC RAILROAD COMPANY TO EITHER MR. T. H. SCHUMACHER,
MR. W. J. CURRY, OR MISS MARY VALDERS IN ADDITION TO THOSE PAYMENTS INCLUDED IN STATEMENT NO. 1

PERIOD MARCH 16, 1943 TO MARCH 31, 1948

		JANUARY	FEBRUARY	MARCH	APRIL	MAY	JUNE	JULY	AUGUST	SEPTEMBER	OCTOBER	NOVEMBER	DECEMBER	TOTAL
YEAR 1943														
T. H. Schumacher	- Pension	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$6,000.00
W. J. Curry	- Pension	89.54	89.54	89.54	89.54	89.54	89.54	89.54	89.54	89.54	89.54	89.54	89.54	638.38
Mary C. Valdars	- Severance Pay													1,239.76
TOTAL - 1943														
		\$1,239.76	\$1,087.74	\$1,051.34	\$1,066.54	\$1,080.54	\$1,080.54	\$1,080.54	\$1,080.54	\$1,080.54	\$1,080.54	\$1,080.54	\$10,076.07	
YEAR 1945														
T. H. Schumacher	- Pension	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$12,000.00
W. J. Curry	- Pension	89.54	89.54	89.54	89.54	89.54	89.54	89.54	89.54	89.54	89.54	89.54	89.54	1,074.48
TOTAL - 1945														
		\$1,080.54	\$1,080.54	\$1,080.54	\$1,080.54	\$1,080.54	\$1,080.54	\$1,080.54	\$1,080.54	\$1,080.54	\$1,080.54	\$1,080.54	\$1,080.54	\$13,074.48
YEAR 1947														
T. H. Schumacher	- Pension	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$12,000.00
W. J. Curry	- Pension	89.54	89.54	89.54	89.54	89.54	89.54	89.54	89.54	89.54	89.54	89.54	89.54	1,074.48
TOTAL - 1947														
		\$1,080.54	\$1,080.54	\$1,080.54	\$1,080.54	\$1,080.54	\$1,080.54	\$1,080.54	\$1,080.54	\$1,080.54	\$1,080.54	\$1,080.54	\$1,080.54	\$13,074.48
YEAR 1948														
T. H. Schumacher	- Pension	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$8,000.00
W. J. Curry	- Pension	89.54	89.54	89.54	89.54	89.54	89.54	89.54	89.54	89.54	89.54	89.54	89.54	668.38
TOTAL TO MARCH 31, 1948														\$ 8,668.38
TOTAL ADDITIONAL AND SUBSEQUENT PAYMENTS														\$38,403.56

3/28/48 - 1/1/48

Office of General Auditor
San Francisco, California
March 31, 1948

EXHIBIT 222 E
1/1/48 EG

EXHIBIT 222 A

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LIST OF CORPORATE OFFICERS AND TERMS THEREOF, JANUARY 1, 1935 TO FEBRUARY 12, 1948

	Year 1935	Year 1936	Year 1937	Year 1938	Year 1939	Year 1940	Year 1941	Year 1942	Year 1943	Year 1944	Year 1945	Year 1946	Year 1947	Year 1948 to Date
President	Charles Elsey	Same	Same	Same	Same	Same	Same	Same	Same	Same	Same	Same	Same	Same
Chairman of the Board	A. C. James	Same	Same	Same	Same	Same	Same	Same	Same	Same	Same	Same	Same	Same
Chairman of the Exec. Comm.	T. H. Schumacher	Same	Same	Same	Same	Same	Same	Same	Same	Same	T. H. Schumacher to 12/28/44	—	—	—
Vice Pres. & General Mgr.	H. W. Mason	Same	Same	Same	Same	Same	Same	Same	Same	Same	Same	H. W. Mason to 4/30/48 H. A. Mitchell from 7/1/48	H. A. Mitchell	Same
Vice President-Traffic	J. F. Hogan	Same	Same	J. F. Hogan to 6/29/38 Vacant from 6/29/38	Vacant	Vacant	Vacant to 12/1/41 H. E. Foulterer from 12/1/41	H. E. Foulterer	Same	Same	Same	Same	Same	Same
Vice President, Asst. Secy., & Asst. Treasurer	H. J. Curry	Same	Same	Same	Same	Same	Same	Same	Same	Same	H. J. Curry to 12/31/45 No successor elected.	—	—	—
Vice President	—	—	—	—	—	—	—	—	—	—	—	—	H. W. Mason from 7/1/48 to 12/31/48	—
Vice President	—	—	—	—	—	—	—	—	—	—	—	—	W. H. Holt from 3/26/45	Same
Secretary	W. G. Brown	Same	W. G. Brown to 6/9/37 G. L. Drost from 6/9/37	C. L. Drost	Same	Same	Same	Same	Same	Same	P. F. Tompkins from 3/26/45	Same	Same	Same
Assistant Secretary	C. L. Drost	Same	C. L. Drost to 6/9/37 Logan Paine from 6/9/37	Logan Paine	Same	Same	Same	Same	Same	Same	Mary Valouch to 4/30/45	Same	Same	Same
Assistant Secretary	—	—	—	—	—	—	—	—	—	Mary Valouch from 12/1/44	Mary Valouch to 4/30/45	—	—	—
Assistant Secretary	—	—	—	—	—	—	—	—	—	—	J. H. Jackson from 3/26/45	Same	Same	Same
Assistant Secretary	—	—	—	—	—	—	—	—	—	—	H. E. Thielking from 3/26/45	Same	Same	Same
Treasurer	H. C. Bates	Same	Same	Same	Same	Same	Same	Same	Same	Same	Same	Same	Same	Same
Assistant Treasurer	—	—	—	—	—	—	—	—	—	H. E. Larson from 12/6/45	Same	Same	Same	Same
General Auditor	D. C. DeGraff	Same	Same	Same	Same	Same	Same	Same	Same	Same	Same	D. C. DeGraff to 6/27/46	G. P. Russell	Same
Assistant to President	—	—	—	—	—	—	—	—	H. W. Morgan from 1/1/1942	Same	Same	Same	Same	Same

Office of Secretary,
San Francisco, Calif.,
February 12, 1948.

15
H. W. Morgan
FEB 12 1948
P.M. 1948
1/16/48

15
H. W. Morgan
FEB 12 1948
P.M. 1948
1/16/48

PLAINTIFF'S EXHIBIT No. 28

Memorandum for File

Supplementing information on the Memorandum of Conference dated June 2, 1943, relating to assumption of certain salaries and expenses of the New York office by the Trustees, the following details are for record:

	Previo-	Previo-	Total	
	ously	ously	now to be	
	paid by	paid by	paid by	Annual
	Trustees	W.P. Corp.	Trustees	Total
M. J. Curry.....	\$ 600.00	\$375.00	\$ 975.00	\$11,700.00
H. Brua Campbell	416.66	208.33	625.00	7,500.00
Mary C. Valouch	191.66	28.33	220.00	2,640.00
John F. Wienken	156.25	83.33	239.58 +	2,875.00
Lillian O'Neill	148.33	21.66	170.00	2,040.00
Catharine C. Sheehan	145.00	20.00	165.00	1,980.00
 Total Salary Roll ...	 \$1,657.90	 \$736.65	 \$2,394.58	 \$28,735.00

(Monthly accounts adjusted end of year to annual totals)

Miscellaneous Expenses

Rent offices	188.34	188.34	376.68	(Month to month)
Electric (approx.)....	18.00	18.00	36.00	
Storage (approx.)	14.00	14.00		
Phone (approx.)	As req'd	25.00	?	
Postage (approx.)	As req'd	18.00	?	
 Total former W.P. Corp. proportion		 1,009.00		

San Francisco

June 2, 1943

(E.W.E.)

[Endorsed]: Filed Feb. 2, 1949.

PLAINTIFF'S EXHIBIT No. 29

New York, January 27, 1943.

Mr. Curry:

My secretary, Mary C. Valouch, who has been doing my work since Walter Mittelberg left, has, as you know, assumed additional duties, particularly of a research and statistical character and handles our tax matters.

She is doing this work in a satisfactory manner so I am increasing her salary, effective January 1, 1943, on The Western Pacific Railroad Company payroll to \$2,300 per year, which is an increase of \$300 a year over her present salary—my former secretary received \$3,400 a year from the Company.

Please arrange your payroll accordingly.

T. M. SCHUMACHER

(Original signed by) T. M. Schumacher.

[Endorsed]: Filed Feb. 2, 1949.

PLAINTIFF'S EXHIBIT No. 30

Memorandum of Conference
June 2, 1943.

At a conference held today between Messrs. Schumacher, Ehrman, Matthew and Elsey, it was agreed that the following changes should be made with respect to employes and expenses of the New York office:

1. Effective as of June 1, 1943, all employes of the New York office heretofore acting as joint employes of the Reorganization Trustees and The Western Pacific Railroad Corporation will be taken over as full time employes of the Trustees, viz:

M. J. Curry
H. Brua Campbell
Mary C. Valouch
John F. Wienken
Lillian O'Neill
Catherine C. Sheehan

2. The Trustees will assume the full rental of the New York office, together with all expenses for miscellaneous supplies and services incident to maintenance of the quarters.

3. It was understood that the above changes will increase the Trustees' expenses by approximately \$1,000 per month. Mr. Curry will continue to report to the General Auditor, as heretofore, details as to salaries and expenses but on the single employer basis now agreed upon.

4. It was agreed that the Trustees would not pay any part of the Corporation's franchise tax (\$1691.75 to April 1944).

5. Although the employes above mentioned will be receiving more compensation from the Trustees than formerly, it is the opinion of Mr. Dooling that no authority will be required from the Salary Stabilization Unit of the Bureau of Internal Revenue with respect to Mr. Curry or from the War Labor Board, with respect to other employes, since none of them will be receiving more compensation from a single employer than they formerly received as joint employes.

6. It was understood that Mr. Schumacher would make necessary application to the Reconstruction Finance Corporation to cover Mr. Curry's increased salary on the Trustees' payroll, such consent from the R.F.C. being necessary in accord with terms of the Trustees' loan agreement with R.F.C.

CHARLES ELSEY.

Copy to Mr. T. M. Schumacher

Mr. Sidney M. Ehrman

Mr. Allan P. Matthew

Mr. D. C. DeGraff

Mr. E. C. Bates

San Francisco, California,

June 7, 1943.

(EWE)

The Western Pacific Railroad Company

37 Wall Street,
New York.

June 18, 1943.

Mr. Charles B. Henderson, Chairman,
Reconstruction Finance Corporation,
Washington, D. C.

Dear Mr. Henderson:

Pursuant to Subdivision (a), Item 3, of Agreement dated November 23, 1938, between the undersigned Trustees in Reorganization of The Western Pacific Railroad Company, Debtor, and the Reconstruction Finance Corporation, and supplements thereto, filed on December 2, 1940 and December 1, 1941, this is to respectfully request the written consent of the Reconstruction Finance Corporation to the following changes in salaries, effective June 1, 1943:

Mr. M. J. Curry, Vice President, Assistant Secretary and Assistant Treasurer, in our 37 Wall Street, New York Office, to be increased from \$600 to \$975 per month.

Mr. H. Brua Campbell, of Pierce & Greer, Counsel at New York, 40 Wall Street, to be increased from \$416.66 to \$625. per month.

These changes are brought about by reason of the fact that, effective as of June 1, 1943, all employees of the New York Office heretofore acting as joint employees of the Reorganization Trustees and The

Western Pacific Railroad Corporation (holding company) will be taken over as full time employees by the Trustees of the Debtor Company.

The total compensation paid Mr. Curry and Mr. Campbell are shown in Exhibit "C" attached to the aforementioned agreement. Mr. Curry's total salary (amended in accordance with your letter of March 25, 1943) remains unchanged. Mr. Campbell's total salary, however, is \$208.33 per month less than shown on Exhibit "C."

Your Corporation's consent to the aforementioned changes will be appreciated.

Yours very truly,

T. M. SCHUMACHER &
SIDNEY M. EHRMAN,
Trustees in Reorganization,

THE WESTERN PACIFIC
RAILROAD COMPANY,

By /s/ T. M. SCHUMACHER,
One of the Trustees.

cc. Messrs. Ehrman, Elsey, Matthew & Nicodemus.

[Endorsed]: Filed Feb. 2, 1949.

PLAINTIFF'S EXHIBIT No. 31

November 9, 1943

Col. Robert E. Coulson
40 Wall Street
New York 5, N. Y.

Re: Western Pacific Reorganization

Dear Col. Coulson:

This will acknowledge receipt of your firm's letter of November 8, 1943, enclosing the report of the Reorganization Committee of the selection of officers and counsel and the designation of mailing address and adoption of by-laws.

This also seems very formal and excessively regular but nevertheless I wish to write informally to congratulate the Reorganization Committee on the selection of your firm as its counsel. As counsel for the Debtor as well as for the Western Pacific Railroad Corporation I stand ready to cooperate to the fullest extent in expediting the reorganization.

At the risk of possible repetition of what I have said to you personally I think your firm will render a distinct service if it insists on the preparation of trust indentures of a somewhat different character than those that have been used in recent reorganizations.

Yours very truly,
F. C. NICODEMUS, JR.

cc:

Mr. T. M. Schumacher.

[Endorsed]: Filed Feb. 2, 1949.

PLAINTIFF'S EXHIBIT No. 32A

April 21, 1945

Mr. Charles Elsey, President
The Western Pacific Railroad Company
526 Mission Street
San Francisco, California

Dear Mr. Elsey:

Since Mr. Droit left I have spent some time discussing with Mr. Schumacher and Mr. Curry some of the problems incident to the closing of the office of The Western Pacific Railroad Company at 37 Wall Street. In this connection I have made certain suggestions, some of which are not a matter of concern to your company but one of which at least is understood to be subject to your approval.

As to Miss Vauloch and Miss O'Neill who have been in the office at 37 Wall Street, I have agreed to employ them in this office quite independently of any tax work being done for your company. They will, of course, lose their Railroad Retirement protection since they leave the employ of a carrier but for that they are compensated by the six months' severance allowance, which I understand your company to have provided. In our opinion the fact that they promptly take employment in this office will have no bearing on the six months' retirement allowance you are giving them.

Mrs. Sheehan, who has been in the office at 37 Wall Street, is not desirous of taking other employ-

ment at the moment and seems quite satisfied with her six months' severance provision.

As to Mr. Wienken, there seems to be no other course than for him, with the protection of his six months' severance pay, to secure other employment. We are not able to make any place for him in this organization or to justify any arrangement to secure his availability in connection with pending tax problems of your company.

As to Mr. Curry, my suggestion has been that this office retain his services for the present on an annual basis to make investigations and furnish us with reports and to be available as a witness in connection with the pending tax questions which your company has up with the Federal Government. As president of the old holding company, which is a party in interest (without financial stake) in the consolidated return period, it seems to us essential that we have Mr. Curry available to secure us necessary data from the files of the holding company. On the other hand, it is not feasible for the holding company to maintain a New York office on its own account because of certain tax problems which arise under New York State laws. Under the arrangement which I have proposed, we would make available to Mr. Curry an office in which he could go over tax data in connection with studies and reports we desire and furnish him with stenographic assistance in compiling his reports. He would not, in any sense, be an "employee" of this office. It is our opinion that such

work as an independent contractor would not constitute "entering the service" of the operating company so as to prevent payments to him under the Provisional Retirement Plan of your company even though we expected, as we would, to be reimbursed by your company for the annual retainer paid him as an expense of the tax proceeding. The same applies, we think, to the Railroad Retirement benefits which Mr. Curry will receive, although we have made no extended study on this point. Mr. Curry, however, will have to resign his position as a nominal vice president of the Denver and Rio Grande for the purpose of stock transfers, in which connection he has been receiving compensation. Otherwise his Railroad Retirement benefits would not accrue.

The amount I suggest by way of annual retainer to Mr. Curry from this firm is \$3,000. There is no doubt in my mind that his usefulness in connection with the tax matters will justify such a payment to him for the next year or two. Taken together with his Railroad Retirement payments and his Provisional Retirement Plan payment, this proposed retainer will also serve to tide him over a period which would otherwise be somewhat difficult for him.

Everyone seems to be in the mood to be quite content and happy if a program, such as is outlined above, can be worked out. This does not mean that Mr. Schumacher views with pleasure not having an office available and he still expresses some

concern as to whether the Western Pacific is wise to be without a New York office other than traffic offices. Also, I received a rather vehement protest from Mr. Nicodemus, whose solution was to have the holding company, in conjunction with the Denver and Rio Grande, continue to maintain the office at 37 Wall Street on a substantially reduced scale. There are, however, obstacles to any such program which seem to me to be insuperable.

Please let me have, as promptly as you can, your reaction to that part of the program outlined above in which the operating company has a definite interest, viz., the proposed retainer to Mr. Curry to be paid by us and reimbursed to us as one of our disbursements in connection with the pending tax matters.

Sincerely yours,

/s/ ROBERT E. COULSON.

[Stamped]: The Western Pacific R.R. Co.,
President, Apr. 24, 1945.

[Endorsed]: Filed Feb. 2, 1949.

PLAINTIFF'S EXHIBIT No. 39e

April 8, 1943

Col. Robert E. Coulson
40 Wall Street
New York, N. Y.

Dear Col. Coulson:

Referring to my recommendation to Messrs. Schumacher and Ehrman that your firm be en-

gaged as advisory counsel to aid Mr. Matthew and me in the solution of the serious problems that will arise in connection with the preparation of final Federal tax returns for the calendar year 1942, I am just in receipt of advice from Mr. Schumacher that this recommendation in which Mr. Matthew has concurred is agreeable to the two Trustees and that they desire me to arrange forthwith for your firm's services.

Since you already have advised me informally of your firm's willingness to undertake this work I write merely to confirm the arrangement and to say that I will hold myself in readiness to confer with your Mr. Polk and to make available to him such data as has been supplied to me and such further data as he may desire.

The firm of Lybrand, Ross and Montgomery has been employed in connection with certain accounting problem and I understand their services will be available to us to the extent that we deem necessary.

Yours very truly,

/s/ F. C. NICODEMUS, JR.

[Endorsed: Filed Feb. 2, 1949.]

PLAINTIFF'S EXHIBIT No. 39F

April 20, 1943

F. C. Nicodemus, Jr., Esq.
40 Wall Street
New York, N. Y.

Western Pacific

Dear Mr. Nicodemus:

This is a belated acknowledgement of your letter of April 8, 1943. I had assumed from its text and from the fact that Mr. Polk and you were already at work when I received your letter that you needed no formal acknowledgment. However, it may be better, as a matter of record, that you should have a formal acknowledgment of the fact that we have undertaken the Federal tax work for the Trustees as advisory counsel in conjunction with yourself and Mr. Matthews.

Sincerely yours,

/s/ ROBERT E. COULSON.

[Endorsed]: Filed Feb. 2, 1949.

PLAINTIFF'S EXHIBIT No. 42

The Western Pacific Railroad Company

November 15, 1948

To Whitman, Ransom, Coulson & Goetz, Dr., Attorneys and Counsellors at Law, 40 Wall Street, New York.

Final statement covering professional services in connection with Federal tax disputes as to the taxable period from January 1, 1942, through April 30, 1944 \$300,000.00

Retainer payments, July 1, 1945, to December 31, 1948, to M. J. Curry..... 10,500.00

Total \$310,500.00

Received Payment,

Whitman, Ransom, Coulson & Goetz
40 Wall Street, New York

December 19, 1947

Mr. Charles Elsey, President
The Western Pacific Railroad Company
526 Mission Street
San Francisco, California

Dear Mr. Elsey:

In connection with the tax work which I and my associates have been carrying on for The Western

Pacific Railroad Company during the 1947 calendar year I have had prepared a statement which is enclosed. This statement covers such services on a time basis and does not purport to include any fee for the substantial tax savings effected for the period from 1942 through the first four months of 1944. You will, I think, concur in my view that any statement covering the fee for this special tax matter should not be determined or submitted until any possibility that the settlement agreement might be reopened by the Treasury Department is foreclosed by the expiration of the statutory period of limitations as to all the taxable years involved, and possibly even until there is at least a preliminary determination in the pending litigation in which The Western Pacific Railroad Corporation is seeking to assert an interest in such tax savings.

When you have reviewed the enclosed statement for current services, and the disbursements in connection therewith, please call me up if there is any question in your mind about them. From the standpoint of The Western Pacific Railroad Company it might be better to have any payment made on account of these services made during the current calendar year.

Sincerely yours,

/s/ JAMES K. POLK.

[Stamped]: The Western Pacific Railroad Co.,
President, Dec. 22, 1947.

Whitman, Ransome, Coulson & Goetz
40 Wall Street, New York

November 15, 1948

Mr. Charles Elsey, President
The Western Pacific Railroad Company
526 Mission Street
San Francisco, California

Dear Mr. Elsey:

On December 19, 1947, I wrote you as to the time when a bill should be rendered covering the services of myself and my associates in connection with the special Federal tax matter which resulted in substantial tax savings for the period from January 1, 1942 to May 1, 1944. It was suggested in my letter that no statement should be submitted for this special tax matter until the settlement agreement was protected from any suggestion on the part of the Treasury Department that the matter be reopened prior to the expiration of the statutory period of limitations as to all the taxable years involved. The statutory period of limitations as to the years involved ended on June 30th of this year and so far as that element is concerned there is no reason why a final statement should not be rendered.

My letter of December 19, 1947 also raised for consideration the possibility that a final bill might be deferred until there had been at least a preliminary determination in connection with the litigation in which the Western Pacific Railroad Corporation is seeking to assert an interest in the bene-

fits derived by The Western Pacific Railroad Company from the final disposition with the Treasury Department of the issues for the taxable period mentioned. We have given consideration to this aspect of the matter and have reached the conclusion that the balance of advantage to your company would be to have a final bill rendered during the calendar year 1948. You will no doubt wish to discuss this aspect of the matter with Mr. Matthew, as counsel for your company in the pending litigation between The Western Pacific Railroad Corporation and your company.

In order to put this matter in concrete form, I am enclosing a statement covering such services. The amount shown by this statement seems to us to represent a fair and reasonable basis of charge. In addition the statement shows the retainer payments which have been made and are being made through this office until the end of the current year to Mr. Curry in order that he might be available for research and as a witness in the event the matter had gone to trial instead of being settled.

If there is any aspect of this matter as to which you wish further information, do not hesitate to call me up here in the office.

Sincerely yours,

/s/ JAMES K. POLK.

[Stamped]: The Western Pacific Railroad Co.,
President, Nov. 19, 1948.

[Endorsed]: Filed Feb. 2, 1949.

PLAINTIFF'S EXHIBIT No. 43

Whitman, Ransom, Coulson & Goetz
40 Wall Street, New York

July 25, 1944

M. J. Curry, Esq., President,
The Western Pacific Railroad Corporation,
37 Wall Street,
New York 5, N. Y.

Dear Mr. Curry:

We have given the matter of adoption of declared value on the 1944 Capital Stock Tax Return for The Western Pacific Railroad Corporation consideration after discussing with Miss Valouch and Mr. Reilly the present estimates of declared value excess profits tax net income for the calendar year 1944.

You realize that the tax statute does not attempt to require a measurement of real or actual value of the capital stock and that the problem involved in the adoption of a declared value is one of selecting an amount which will incur a minimum combined capital stock tax and declared value excess profits tax liability. The adoption of a declared value of at least ten times the estimated taxable income for the year 1944 is necessary to escape the declared value excess profits tax provisions of the Act and a reasonable margin of protection must be added to provide for possible increases in taxable income over any present estimate.

The best judgment of the Company officials and

employees would seem to be that there will be no declared value excess profits tax net income derived by the Corporation for the calendar year 1944. Accordingly, it is believed that the capital stock tax return may properly reflect a declared valuation of zero for the Western Pacific Railroad Corporation.

We have also reviewed the draft of the capital stock tax return and accompanying statement of Trustees which has been prepared for The Western Pacific Railroad Company. Since it is believed that the Corporation will not have title to the property during the calendar year 1944 and the ownership will continue in the Trustees in Reorganization, the return and accompanying statement of Trustees reflects no capital stock tax liability for The Western Pacific Railroad Company.

Review has also been had of the copies of capital stock tax returns proposed to be filed for the Sacramento Northern Railway, the Tidewater Standard Railway Company, The Western Realty Company, the Standard Realty and Development Company and the Delta Finance Company, Ltd. As previously stated, the basis of the declaration of value should be at least ten times the estimated declared value excess profits tax net income of each corporation. Under the method of computing the declared value excess profits tax liability this income is substantial statutory revenue less statutory deductions, the net result of which is reduced by 85% of the dividends received from domestic corporations and by 10% of the valuation declared on the capital stock

tax return. It is assumed that the respective corporate officials have based their declarations of value on estimates of income for these Companies for the year 1944 so as to eliminate through the 10% credit on the declared value any declared value excess profits tax net income. We have no means of reviewing with the Company officials the estimates of income which formed the bases for the adopted values set forth in the capital stock tax returns.

The copies of the returns which were submitted with your letter of July 19th are herewith returned to you. It is requested that at your convenience copies of these papers be furnished us for our files. It is assumed that you will wire Mr. DeGraff so that the returns may be timely filed by him.

Very truly yours,

WHITMAN, RANSOM, COULSON & GOETZ.

July 26, 1944

Via air mail: Special Delivery.

Mr. D. C. DeGraff, General Auditor,
The Western Pacific Railroad Company,
526 Mission Street,
San Francisco 5, Calif.

Dear Mr. DeGraff:

After receiving copies of the 1944 Returns of Capital Stock Tax, which were enclosed with your letter of July 21st, they were delivered to our Tax

Counsel, Mr. James K. Polk of Whitman, Ransom, Coulson & Goetz, for his review, having previously submitted to him for consideration the question of the parent company's Capital Stock Tax Return.

I am in receipt of a reply from his firm, copy of which I am enclosing for your information.

I am also enclosing 1944 Return of Capital Stock Tax for The Western Pacific Railroad Company and Statement of Trustees, both executed by Mr. T. M. Schumacher, as Trustee. We would appreciate it if you will send us conformed copies of all returns filed for our records.

Yours very truly,

/s/ M. J. CURRY.

cc. Mr. James K. Polk:

Mr. F. C. Nicodemus, Jr.

[Endorsed]: Filed Feb. 2, 1949.

PLAINTIFF'S EXHIBIT No. 50

Whitman, Ransom, Coulson & Goetz
40 Wall Street, New York

May 20, 1943

Mr. M. J. Curry,
Vice President,
Western Pacific Railroad Company,
37 Wall Street,
New York, N. Y.

Dear Mr. Curry:

On May 15, there were filed at the Office of the Collector of Internal Revenue, Custom House, New York, the Federal income, excess profits tax and declared value excess profits tax returns for the Western Pacific Railroad Company and its affiliated corporations. The items entering into the preparation of these returns were reviewed by us and on the basis of the information available, it is believed that the returns as filed met all of the conditions of the Internal Revenue Code and Bureau regulations in respect of the substantive matter contained therein and of supporting schedules.

It is believed, however, that a considerable amount of supporting detail and underlying data must be prepared in order that the figures set forth in the return can be supported upon subsequent Bureau audit. While it is true that much of this underlying detail will relate to the earnings and profits determination which, in turn, will probably

Plaintiff's Exhibit No. 50—(Continued)
have little effect upon invested capital, it is believed, however, desirable that the research be carried through in order that the position we assert in the returns may be hedged against the adverse implications of possible distributions out of capital which may have occurred up to the date of the last dividend payment in 1927. Further, we have used in the returns, book costs as bases for the affiliated corporations' stock investments which again may require adjustments, possible of determination only after such analyses.

It is also believed desirable to have a more complete review made of the computation of the unused excess profits credit adjustment. In the return as filed, it was assumed that the invested capital base for the years 1940 and 1941 was substantially the same as for the taxable year 1942. Undoubtedly, changes will be indicated when the schedules for borrowed invested capital and inadmissible adjustments for 1940 and 1941 have been prepared in detail. This adjustment will, in all probability, have no effect upon the 1942 tax return but will afford a more proper basis for administrative consideration of tax matters for 1943 and subsequent years.

It is further noted that a historical development of the profit and loss accounts of the several companies, not only as disclosed in their books, but as set forth in the reconciliations reported in prior Federal income tax returns, will bring to light any

Plaintiff's Exhibit No. 50—(Continued)
instances of write-ups, write-downs, etc. The survey of this character will also serve to establish more definite amounts of net operating loss deductions and carryovers.

Both in connection with the review of the deductions claimed for depreciation and the amounts shown for fixed capital investment returns, it will be helpful to review the significant tax positions adopted by the company and accepted by the Bureau of Internal Revenue in connection with the audits by the Bureau of Internal Revenue of prior year income tax returns. While not estopped by prior considerations and decisions, the Bureau may be disinclined to depart from previous determinations of basis of fixed capital investments as shown by treatment in computing depreciation deductions and in computing gains and losses upon the disposition of assets.

It may also be noted that it is clearly demonstrable that the consolidated return basis of reporting for the year 1942 as contrasted with a separate basis of reporting, was advantageous to the group. Since consolidated returns were filed for 1940 and 1941, any unused excess profits credit inhered in the common parent corporation, had separate returns been filed for 1942. A preliminary survey of the smaller affiliates indicates that they would have incurred no excess profits tax liability. The operating company, however, if placed on a separate basis without the benefit of the credit carry-

Plaintiff's Exhibit No. 50—(Continued)

overs, would have been liable for a net excess profits tax liability of \$3,650,000 even if all other figures as shown in the return were left unchanged. This amount is offset by several factors. In the first place, on an individual basis, the operating companies' interest on expense deductions would have increased \$703,000. It would have lost, however, its allocable share of the net operating loss reduction of approximately \$438,000. Further, a portion of its earnings subject to excess profits tax rates would have been eliminated from normal tax rates. There would have been, in addition, a reduction in the surtax rate on a separate basis of the 2% penalty for filing a consolidated return, which would have amounted to approximately \$200,000 in tax. All of these factors combine to establish a net tax advantage of in excess of \$1,550,000 in the adoption of the consolidated return under the separate return.

There is a further possibility of adjustment under the Internal Revenue Code provisions contained in Sections 23(g)(4) and (k)(5) by which the worthlessness of the operating company's stock may produce a net loss for the year 1943 with possible carryback application. This is commented upon rather than suggested as of certain value, since it is paradoxical to compute a loss upon the operating company's stock which, through the mechanics of consolidated return reporting, could be used to nullify the very income of the affiliate whose

Plaintiff's Exhibit No. 50—(Continued)

stock had become worthless. This matter will receive more careful consideration when the completion of the reorganization makes possible the assertion of the claim for worthlessness of the operating company's stock.

Apart from the 1942 tax liability, we are informed that a request has been addressed to the company for the submission of basic data to be considered by the Bureau of Internal Revenue in connection with the application made under date of March 29, 1943, for permission to change the method of accounting from retirement to a depreciation basis for Federal income tax purposes. Under general procedures adopted in the Bureau the permission to change the basis of accounting is premised upon the agreement of the applicant to adoption of accumulated depreciation reserve balances which, at the election of the company, may be determined by any one of the following methods:

1. The accounts may be reconstructed from their beginning, or may start with the I.C.C. valuation, setting up as a reserve the difference between cost of reproduction new and cost of reproduction less accrued depreciation as determined at the valuation date. From either starting point, the capital accounts shall be carried forward, increased by additions and decreased by retirements, except that any increase in replacement costs, or additions or betterments expensed, which have been deducted for

Plaintiff's Exhibit No. 50—(Continued)
income tax purposes, may not be restored. Depreciation at rates to be agreed upon shall be computed for all years and accrued into a depreciation reserve. From this reserve shall be deducted the cost of normal retirements, but for retirements due to casualty or special obsolescence, which would have been allowable under depreciation accounting, only the accrued depreciation thereon shall be deducted.

2. A reserve may be set up by multiplying the expired life of individual structures, or the weighted average ages of the accounts representing groups of assets, now in service, by the depreciation rates agreed upon for these assets.

3. A reserve of 30% of the total depreciable accounts at the date of change may be set up. It is to be understood that this is on overall reserve and the total amount so computed is to be allocated to the different depreciable accounts on a reasonable basis, such allocation to be a matter of agreement between each railroad and the Bureau.

We are familiar with the requirements of the Bureau of Internal Revenue in connection with depreciation computations generally embodied in the Valuation Division questionnaire, the provisions of T.D. 4422 and related Bureau rulings, and have discussed the railroad situation with the Bureau of Internal Revenue officials to whom these matters are assigned. It will, undoubtedly, be necessary

Plaintiff's Exhibit No. 50—(Continued)
to complete preliminary computations under the elective methods prescribed, and to compare the possible annual benefits of depreciated accounting with the retirement basis heretofore followed, before administrative action can be taken to complete the application for permission to change accounting basis filed with the Bureau of Internal Revenue.

We will be glad to confer with your company officials in planning these preliminary surveys so, if possible, to minimize the work required and will be glad to make available to you the benefit of our experience in the assembly and presentation of data to the Bureau of Internal Revenue, if you elect to take advantage of the depreciation basis of tax accounting for 1943.

Very truly yours,

/s/ JAMES K. POLK.

[Stamped]: The Western Pacific Railroad Corp., Received May 21, 1943.

[Stamped]: T. M. S. May 21, 1943.

[Endorsed]: Filed Feb. 2, 1949.

U R G E N T

June 26, 1943

MEMO FOR ~~MR. J. C. DUNN~~

Western Pacific

Will it embarrass you in the Western Pacific situation if the corporate charter of the Western Pacific Corporation is cancelled by the State of Delaware for failure to pay its 1940 Delaware franchise tax prior to July 1, 1943?

REC

Until the Reorg. program we are urging for incorporation into the Internal Revenue Code are adopted it is essential to protect the possible use of the net loss carryover that the holding company continue until the consummation of the reorganization. It would require more study of the causal. Retire regular before all the advantages of continuation & chart before 6/30 can be noted.

Photo

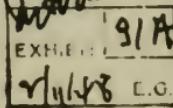
PIERCE & GREER

40 WALL STREET

NEW YORK

RECEIVED
PIERCE & GREER1001 FIFTEENTH STREET,
WASHINGTON, D.C.

May 26, 1943



Mr. James K. Polk
40 Wall Street
New York, N. Y.

Dear Mr. Polk:

Attached is form of communication to security holders which The Western Pacific Railroad Corporation would like to hand out to persons applying at its office for information as to the status of the Corporation.

Is there any reason in your mind, in connection with your letter to the Railroad Company of May 20, 1943, why the Corporation should not do this?

Yours very truly,

F. C. Nicodemus, Jr.

F. C. Nicodemus, Jr.

S. DIST. CT. N. D. CAL.
26508-6
Lia. 52
ED. FEB. 2 1949.
R. CALIFORNIA, San Francisco

R. Ellington San Francisco (Calif.) 4-10-43
replied to my letter of 4-1-43 and said
objection was that it actual documents
should be kept in trust by the
management - he suggested another and
urged me to do so. 4-1-43
31A

The Western Pacific Railroad Corporation

37 Wall Street

New York, N. Y.

To Holders of The Western Pacific Railroad Corporation Preferred Stock and Common Stock:

As information, we give you below a brief statement as to the status of this Corporation.

This Corporation is a holding company and not an operating railroad company. Its investments comprise the common and preferred stocks of The Western Pacific Railroad Company, one-half of the common stock of The Denver & Rio Grande Western Railroad Company and, in addition, certain other securities of both companies. These operating companies have been in process of reorganization since late in 1935, and, as a result, the Corporation has received no income on these investments during that period.

Aside from the preferred and common stocks of The Western Pacific Railroad Company, the balance of the securities owned by this Corporation are pledged as collateral under loans which have been in default since 1934 and on which interest has accumulated.

After lengthy court procedure, throughout which this Corporation was represented by Counsel to protect the interests of its stockholders, the Western Pacific case was appealed to the United States Supreme Court for review. On March 15, 1943,

that court rendered its decision, affirming the plan of reorganization which was promulgated by the Interstate Commerce Commission and approved by the Federal District Court in San Francisco. That plan declares the unsecured indebtedness and the preferred and common stocks of The Western Pacific Railroad Company to be without value.

The bank serving as Registrar of the Corporation's preferred and common stocks, having given notice of its resignation, effective May 1, 1943, and in view of the poor financial condition of the Corporation, it was determined by the officers that as Corporation no certificates for preferred stock or preliminary to liquidation and dissolution of the common stock would be accepted for transfer after April 29, 1943. The New York Stock Exchange suspended trading in the preferred stock on April 29, 1943 (the common stock had been delisted in 1939, since which time it has been traded in the Over-the-counter market).

In view of the Supreme Court's decision, which indicates clearly that the unsecured indebtedness and the preferred and common stocks of The Western Pacific Company (all owned by this Corporation) are of no value and, further, that all other securities owned by the Corporation are pledged as collateral under loans in default, and as the Corporation is without funds to continue its corporate existence, we regret to state we do not believe that during the course of liquidation and dissolution any assets will remain for distribution to holders

of the Corporation's preferred and common stocks.

JOHN F. WIENKEN,
Secretary.

date?

[Endorsed]: Filed Feb. 2, 1949.

PLAINTIFF'S EXHIBIT No. 53

January 8, 1944

Memorandum

In Re: Western Pacific Reorganization Trustees
1943 Federal Income Tax Return

Conferences were held today with Mr. Elsey, Mr. Englebright, Mr. DeGraff, and Mr. Gloster at the Company offices, and with Mr. Elsey and Mr. Matthew at luncheon in connection with the deduction to be claimed by the parent company on loss on the operating company's stock, their effect thereof upon the tax liability of the subsidiary operating company.

It was explained that under Internal Revenue Code provisions losses on the stock of operating subsidiary companies were specifically removed from the capital gains and loss classification and accordingly allowed as operating losses and, on consolidated return treatment the parent company loss could offset subsidiary company incomes.

The Western Pacific Railroad Corporation's investment in the (operating) Western Pacific Railroad Company's stock has been shown at \$75,000,000.

The basis is under any calculation well in excess of the operating income of the operating company for 1943.

There has been accrued on the operating company's books through November a reserve for Federal tax liability of approximately \$7,500,000. Since there will be no tax liability if this operating loss deduction on the consolidated return basis is allowed the suggestion was made that the books of account be adjusted so as to reflect at December 31 no accrual for Federal tax liability on the part of the operating company for 1943.

After considerable discussion it was decided tentatively to set up a "Reserve for Road Improvement" in an amount approximating the \$7,500,000 figure. This action is to be taken upon order of the court after appropriate application for same. As a preliminary step the procedure is to be further studied and submitted to the Reorganization Committee for their approval, which if obtained is to be then submitted to the Trustees for their approval. In support of the dollar reserve, accrual engineering studies are to be compiled showing cost of change of existing rails from 80 to 112 pounds, installation of continuous block system, substitution of concrete for timber tunnel linings, and possibly extension of centralized traffic control. Studies are also to be included of cost of acquiring modernized passenger and freight equipment. Further conferences are to be held Monday on these matters.

Mr. Gloster furnished the undersigned with a

preliminary draft of engineering studies on machinery and equipment investments for consideration in connection with the Bureau requirements for submission of data under Treasury Mimeograph 58.

Discussions were also had with Mr. Matthew and Mr. Elsey concerning the program for corporate readjustment and substitute lease arrangements with the Salt Lake City Union Depot and Railroad Company. Mr. Matthew has completed a draft of lease and a copy is to be furnished me for review. In the draft Mr. Matthew has made provision for limited preferred stock dividend requirements, but in the light of the discussion of Mr. McAllister's suggestions has noted that these provisions are subject to revision to accord with the proposals prepared by Mr. Hart and the undersigned. Mr. Matthew is to join in the conferences to be held Monday in regard to both the tax return and the Salt Lake Depot matters. A request was made that opinion letter of counsel be drafted covering the tax return deduction item and this will be done after review of the applicable statutory provisions Monday.

J. K. P.

[Endorsed]: Filed Feb. 2, 1949.

PLAINTIFF'S EXHIBIT No. 58

Filed Feb. 21, 1944

C. W. Calbreath, Clerk

Allan P. Matthew,
1500 Balfour Building,
San Francisco 4, California

In the District Court of the United States, for the
Northern District of California, Southern Division

No. 26591-S

7100 000

In the Matter of
THE WESTERN PACIFIC RAILROAD COMPANY,

Debtor.

PETITION FOR AUTHORITY TO ESTABLISH A RESERVE FUND FOR CONTINGENT TAX LIABILITIES

T. M. Schumacher and Sidney M. Ehrman, the duly appointed, qualified and acting Trustees of the properties of the Debtor above named, hereinafter referred to as the Trustees, hereby represent to the Court and petition as follows:

I.

The Trustees are advised and believe that the Debtor and the Trustees have no Federal income or excess profits tax liability for the year 1943. However, the Commissioner of Internal Revenue

has not yet passed upon the question, and the Trustees believe that it is in the best interests of the estate of the Debtor to provide a reserve fund out of which 1943 Federal income and excess profits taxes may be paid in the event that liability therefor should be established. The Trustees are advised and believe that the sum of \$7,100,000 will be adequate to cover any possible liability for such taxes for the year 1943. The estate of the Debtor contains sufficient cash derived from the earnings of the railroad of the Debtor during the year 1943 to establish a reserve fund in the amount of \$7,100,000 without using funds required for other purposes.

II.

It is the judgment of the Trustees that such reserve fund should be invested in United States Treasury securities. The Trustees propose to designate the fund as the "Reserve Fund for Contingent Tax Liabilities."

Wherefore, your petitioners pray that they be authorized to establish, out of the earnings of the railroad of the Debtor during the year 1943, a reserve fund in the amount of \$7,100,000, to be designated as the "Reserve Fund for Contingent Tax Liabilities," to be invested in United States Treasury securities, and to be used for the payment of any Federal income and excess profits taxes which may be found due for the year 1943.

ALLAN P. MATTHEW,
Counsel for Petitioners.

State of California,
City and County of San Francisco—ss.

Charles Elsey, being first duly sworn, deposes and says:

That for more than twelve years last past he has been the President of The Western Pacific Railroad Company and since the appointment of the Trustees of the properties of said Company he has been their Agent in immediate charge of the railroad and other property of that Company; that he has read the foregoing petition and knows the contents thereof and the same is true of his own knowledge.

CHARLES ELSEY.

Subscribed and sworn to before me this day of February, 1944.

[Notarial Seal]

.....
Notary Public in and for the City and County of San Francisco, State of California.

[Endorsed]: Filed Feb. 3, 1949.

PLAINTIFF'S EXHIBIT No. 63

January 23, 1945

Memorandum for Colonel Coulson:

The Western Pacific Railroad Company Journal
Entries Reflecting Completion of Reorganiza-
tion

A conference was held today by Colonel Coulson, L. J. Gosney and the undersigned in which were

Plaintiff's Exhibit No. 63—(Continued)

discussed the principles involved in the suggested journal entries attached to and made a part of the memorandum of conference of January 17, 1945, with the Bureau of Accounts of the Interstate Commerce Commission.

It was noted that the fundamental premise of such journal entries was that there must be reflected upon the books of the continuing corporate entity the factual changes occasioned by the reorganization, and that this premise necessarily rejects any such concept as the Bureau of Accounts apparently had when they suggested in their letter of December 6, 1944, opening up a new set of books for a new corporation.

It was clearly understood and agreed that under no circumstances would the corporation jeopardize its primary tax advantage deliberately secured through the maintenance of the continuity of the 1916 corporation by voluntarily filing any proposed journal entries of the type suggested in the letter of December 6, 1944. Subject to such amendments, additions and corrections of dollar figures as will develop from the use of the December 31, 1944, closing figures, it is the position of counsel and of Colonel Coulson as a member of the Board, that the entries as reflected in principle in the memorandum of the January 17th conference should form the basis of the proposed journal entries to be prepared and submitted for Interstate Commerce Commission consideration.

Plaintiff's Exhibit No. 63—(Continued)

There is attached a photostatic copy of a work sheet reflecting the type of balance sheet before and after journal entries of the kind indicated in the January 17th memorandum. It was noted, of course, that the position estimated as of December 31st will probably vary materially in the cash and current asset classifications from the actual figures which will form the starting point for the proposed journal entries and schedules to be submitted to the Interstate Commerce Commission. It will also be noted that the resulting balance sheet will reflect an unearned surplus of approximately \$83,000,000.00 and that of this sum only the amount of \$75,800,000.00 is to be classified as "paid-in surplus" for Federal income tax purposes, the balance constituting "accumulated earnings and profits" in any invested capital or source of dividend distribution computation.

A discussion was also had with regard to the book accounting in respect of the interest on the income bonds. The payment of interest on these securities cannot be determined until sometimes between January and May when the formal action of the Board of Directors in its determination of available income and authorization of the payment of interest is the ultimate act bringing into existence liability on the part of the corporation for payment. Thus from a technical viewpoint the interest is acruable only when and as there is this formal Board action. From a practical viewpoint, there is

Plaintiff's Exhibit No. 63—(Continued)

equal justification for this position since the corporation enjoys the use of the borrowed funds whether or not during each year there are available earnings to pay interest, and the use of the borrowed funds justifies a deduction of compensation equally in every year. The payment within a calendar year is a fair compensation for the actual use of borrowed money during that calendar year.

There is a further tax aspect which is of extreme importance and that is that theoretically and practically there could be no accrual of interest at any time prior to the issuance of the bonds and to insist that there were such an accrual would be an attempt to secure a small interest deduction for 1944 in comparison to the interest deduction now allowable on the old debt structure up to the turnover date under the St. Paul decision. As far as is concerned the practical booking of interest on the income bonds in 1945, subject to some objection which we cannot find in the Interstate Commerce Commission's prescribed system of accounts, it might be that there could be accrued monthly one-twelfth of an estimated annual interest payment on the bonds by a debit to interest expense and a credit to a reserve for estimated interest liability. Upon the payment of interest, for instance in May of 1945, cash could be credited and this reserve debited and the reserve balance immediately after such entry constituting a deferred charge to the remaining months in the year would be absorbed by the monthly entries of the

Plaintiff's Exhibit No. 63—(Continued)

remaining months in the year. In this manner there would be no distortion as between months of income statements. As to the handling of this, however, in the current accounts—so long as there is no reflection of liability at December 31, 1944, for any accrued interest on the income bonds—this office would be glad to receive the comments and suggestions of the accounting officers of the corporation.

Colonel Coulson suggested that as soon as the December 31st figures are available every effort should be made to have a preliminary draft of the journal entries prepared and forwarded to this office for review as to tax implications as well as for Interstate Commerce Commission presentation purposes. It was his suggestion that a memorandum of this conference and of the January 17th conference together with the exhibits be forwarded to Mr. DeGraff so as to give Mr. DeGraff the viewpoint of this office on these matters.

J. K. P.

[Endorsed]: Filed Feb. 3, 1949.

PLAINTIFF'S EXHIBIT No. 64

Whitman, Ransom, Coulson & Goetz
40 Wall Street, New York 5, N. Y.

May 31, 1946

Mr. C. R. Krigbaum
Internal Revenue Agent in Charge
225 Broadway
New York, N. Y.

Attention: Mr. T. K. Leahy

The Western Pacific Railroad Corporation
Federal Income Taxes 1942 and 1943

Dear Sir:

The audits of the Federal Income Tax Returns filed by the above named corporation are now being made by representatives of your office. In advance of the consideration of other issues, preliminary review is being given to the deduction claimed in the 1943 tax return for the loss sustained in the worthlessness occurring during that year in the stock of The Western Pacific Railroad Company. In order to facilitate the consideration of this matter, and without any attempt at this time to submit arguments in support of the claim of the taxpayer, there is furnished below a summary of the facts believed pertinent in this matter. The taxpayer specifically reserves the right to supplement this statement of facts and to submit a brief in support of the propriety of the claim for deduction in 1943.

The Western Pacific Railroad Corporation was

Plaintiff's Exhibit No. 64—(Continued)
organized under the laws of the State of Delaware
in 1916 and has owned at all times from on or about
July 14, 1916, to April 30, 1944, all of the outstanding
stock of The Western Pacific Railroad Company.
This latter company is a California corporation
which has owned and operated railroad properties
in the States of California, Nevada and Utah
from 1916 to date. On August 2, 1935, a petition
was filed in the United States District Court for
the Northern District of California, Southern Division,
for reorganization of The Western Pacific
Railroad Company under the provisions of Section
77 of the Bankruptcy Act, as amended; simultaneously,
a copy of said petition was filed with the
Interstate Commerce Commission.

During 1936, 1937 and 1938 various plans of reorganization were filed with the Interstate Commerce Commission and hearings were held by the Commission. The resulting plan of reorganization formulated by the Interstate Commerce Commission was duly certified to the United States District Southern Division, and that Court after further hearings and argument, on August 15, 1940, entered an order approving the plan of reorganization proposed by the Interstate Commerce Commission.

All plans of reorganization filed with the Interstate Commerce Commission by the parties recognized value for the stock of The Western Pacific Railroad Company. The exclusion of the stock

Plaintiff's Exhibit No. 64—(Continued)

from participation by the Interstate Commerce Commission in the plan which it promulgated was vigorously contested before the Commission and before the United States District Court, both by the debtor company and by other parties to the proceeding.

Appeals were duly taken from the aforesaid order of the United States District Court to the United States Circuit Court of Appeals, Ninth Circuit, and in a decision handed down November 28, 1941, the Circuit Court of Appeals reversed the order of the District Court and ordered the case remanded for further proceedings. A principal contention of the debtor company, The Western Pacific Railroad Corporation, and other appellants before the Circuit Court of Appeals, was that the asset value and earning power of the debtor justified the participation of its stock in the reorganization. The Circuit Court of Appeals sustained this contention to the extent of holding that the Commission and the District Court had made no findings to justify the exclusion of this stock from participation. The Commission plan was based upon a forecast of earnings in the light of the worst depression experience the railroads had ever had. It is submitted that it is obvious that at the time of the Circuit Court of Appeals' decision the financial condition of the debtor was such that it would have been impossible to make any current findings of fact which would exclude the stock from participation in the reor-

Plaintiff's Exhibit No. 64—(Continued)

ganization. Accordingly, the Circuit Court of Appeals' reversal of the District Court was a practical insurance of participation in the reorganization by the equity ownership of the debtor company.

Petitions for certiorari to review the Circuit Court of Appeals decision were filed in the United States Supreme Court early in 1942. These petitions for review were granted by the Supreme Court on April 27, 1942, and the matter was argued before that Court in October, 1942. In the proceeding before the Supreme Court, the debtor and The Western Pacific Railroad Corporation both vigorously presented the claim that the decision of the Circuit Court of Appeals be sustained and that the demonstrated earning power and fair value of the operating properties warranted recognition of value for the stock. On March 15, 1943, the United States Supreme Court reversed the Circuit Court of Appeals and sustained the United States District Court, remanding the case to that Court for further proceedings under the provisions of Section 77 of the Bankruptcy Act. A petition for rehearing in this matter was denied by the Supreme Court and its decision became final on or about April 19, 1943.

Thereafter during the year 1943 the proceedings which are expressly required by the provisions of Section 77 of the Bankruptcy Act, as preliminary to a confirmation of a plan of reorganization, were taken in this case. The votes of security holders on acceptance of the plan were canvassed

Plaintiff's Exhibit No. 64—(Continued)

and recorded by the Interstate Commerce Commission. The favorable result of the vote was duly certified by the Interstate Commerce Commission to the United States District Court as required by the Bankruptcy Act. Thereafter upon notice to all parties and publication, a hearing was had on the confirmation by the United States District Court. On the record made at such hearing, the District Court under date of October 11, 1943, entered its order of confirmation of the plan. No appeals were taken from said order and it became final on or before November 20, 1943.

Under the plan of reorganization so confirmed by the United States District Court, The Western Pacific Railroad Corporation was excluded from any participation, and its stock ownership in The Western Pacific Railroad Company thereupon became worthless. The taxpayer claims that the stock of The Western Pacific Railroad Company at all times, until the date of the Supreme Court decision March 15, 1943, had a real and material fair market value, and that the stock became worthless on or after March 15, 1943, and, accordingly, that the loss occasioned by the worthlessness of the stock was properly deductible under the provisions of Section 23 (g) of the Internal Revenue Code in the determination of the consolidated taxable net income for 1943.

Very truly yours,

WHITMAN, RANSOM,
COULSON & GOETZ.

PLAINTIFF'S EXHIBIT No. 65

Know All Men By These Presents, that The Western Pacific Railroad Corporation, a Delaware corporation, by these presents hereby makes, constitutes and appoints James K. Polk and Harold F. Noneman, of the law firm of Whitman, Ransom, Coulson & Goetz, 40 Wall Street, New York 5, New York, and Patrick J. Cavanaugh, an attorney associated with said firm, or either of them, its true and lawful attorneys, to appear for it and represent it before the Treasury Department, in connection with any matter involving its Federal Income Tax for the taxable years 1940 to 1945 inclusive, and to appear for and represent it before the Bureau of Internal Revenue, or any unit, division, or agent or employee thereof relative to any tax liability claimed against it for the taxable years 1940 to 1945 inclusive, giving and granting its said attorneys full power to do everything whatsoever requisite and necessary to be done in the premises, and to receive refund checks, to execute waivers of the statute of limitations, and to execute closing agreements, as fully as the undersigned might do if personally present, with full power of substitution and revocation, at any time subsequent to the date hereof and prior to the revocation hereof.

It is hereby requested that a copy of all communications regarding any matter in which the said attorneys are hereby authorized to act be addressed to James K. Polk, Esquire, at his office address, 40 Wall Street, New York 5, New York.

All powers of attorney heretofore given for the purposes herein enumerated by the undersigned are hereby revoked.

In Witness Whereof, the said The Western Pacific Railroad Corporation has caused its corporate name to be signed hereto by its President and its corporate seal affixed and attested by its Secretary all as of the 26th day of June, 1946.

THE WESTERN PACIFIC
RAILROAD CORPORATION,

[Seal] By /s/ M. J. CURRY,
President.

Attest:

/s/ M. C. VALOUCH,
Secretary.

[Endorsed]: Filed Feb. 3, 1949.

PLAINTIFF'S EXHIBIT No. 66

[Western Union Telegram Form]

CDU771 NL PD-CD New York NY 6

Allan P. Matthew,
Balfour Bldg., S Fran.

Received Dec. 7, 1946.

Answered 12/7/46 BE

We have an embarrassing situation in connection with examinations before trial in pending stockholders' suits because of various capacities in which

Curry has acted. He is president of the holding company. As such he holds certain files and papers of the holding company. We have pointed out necessity of distinction between these files and files of correspondence written or received by him or Schumacher as former officers of operating company. These files belong to operating company and should be technically in our custody as tax counsel insofar as they involve the tax matters. Curry raises question under your letter May 8, 1945 to bankruptcy trustees. Schumacher asked Curry to act as his representative in retaining custody of trustees books and records. This has been construed to include all correspondence with officers of operating company during reorganization period. In our judgment records directly affecting operating company must necessarily be turned over to operating company by bankruptcy trustees even though they remain available to bankruptcy trustees. Can you clear this situation by wire to us or directly to Mr. Curry?

COULSON.

[Marginal note]: W. P. REORG.

[Stamped]: Received Dec. 7, 1946.

[Stamped]: Ans'd. Dec. 7, 1946.—BE

[Endorsed]: Filed Feb. 3, 1946.

PLAINTIFF'S EXHIBIT No. 68

The Western Pacific Railroad Corporation
100 West Tenth Street,
Wilmington 99, Delaware.

At New York 5, N. Y.

40 Wall Street,
(Fifty-first Floor)

April 4, 1947.

Pierce & Greer,
44 Wall Street,
New York 5, N. Y.

Attention: Mr. F. C. Nicodemus, Jr.

Dear Mr. Nicodemus:

Herewith copy of letter dated April 2, 1947, and enclosure, from Mr. James K. Polk, of Whitman, Ransom, Coulson & Goetz, in regard to the Corporation's Federal Income Taxes for years 1942 and 1943 and period January 1 to April 30, 1944. A copy is also being sent to Mr. A. Perry Osborn.

This will be presented to the Board at meeting called for next Tuesday, the 8th, for consideration and such action as the Board may direct.

Yours very truly,

/s/ M. J. CURRY,
President.

Enclosure

cc. Mr. A. Perry Osborn,
20 Exchange Place,
New York 5, N. Y.

Plaintiff's Exhibit No. 68—(Continued)
(Copy)

Whitman, Ransom, Coulson & Goetz
40 Wall Street, New York.

April 2, 1947.

Mr. Michael J. Curry,
President,
The Western Pacific Railroad Corporation,
Room 5205,
40 Wall Street,
New York, N. Y.

Federal Income Taxes for Years 1942 and
1943 and Period January 1 to April 30, 1944.

Dear Mr. Curry:

As you doubtless know, Internal Revenue Agent Thomas Leahy has been conducting an examination of the operations of The Western Pacific Railroad Corporation and its affiliated companies for the calendar years 1942 and 1943 and the period from January 1 to April 30, 1944. His activities in this connection seem to be approaching completion. I have thoroughly covered with him all phases of the matter and this report is being made to you so that you may be advised of its current status.

In the course of his examination, Revenue Agent Leahy originally determined, on a tentative basis, that the worthlessness of the stock of The Western Pacific Railroad Company occurred in the year 1940. Although in view of the intermediate status of the matter no formal advice or notice of a proposed deficiency had been or could then be received, our ten-

Plaintiff's Exhibit No. 68—(Continued)

tative computations indicated that the deficiencies that would be asserted on the basis of any such determination as to the year of loss, would be considerably in excess of any reserve provision heretofore made against such tax liability. We immediately took the matter up with the local office of the Internal Revenue Agent in Charge, and various conferences were held at which were presented the taxpayer's views that this loss occurred in the year 1943.

The matter was submitted by the Internal Revenue Agent in Charge to the Office of the Commissioner of Internal Revenue in Washington, D. C. for advice. Conferences were held with Bureau officials in Washington in connection therewith. It was first proposed by the Bureau officials at Washington to support the tentative determination of the field examiner that the stock became worthless in 1940. In further conferences in Washington it was suggested that the matter was one appropriate for disposition by settlement or agreement between the parties. At the request of the Commissioner's Office, a written proposal as a basis for settlement was made by me as attorney-in-fact under date of February 11, 1947, a copy of which I am enclosing. After consideration by the Bureau officials, the case was recently returned by them to the local office of the Internal Revenue Agent in Charge. Revenue Agent Leahy, whose investigation was to a large extent suspended during the pendency of the matter in Washington, has now resumed his activities and is, we believe, now in the process of completing the draft of his report. His

Plaintiff's Exhibit No. 68—(Continued) conclusions, we are hopeful, are now in accord with the proposal submitted to the Washington officials.

The proposal as to a possible basis for settlement is presently pending in the local office of the Internal Revenue Agent in Charge and will continue in that status until final action thereon can be taken by the appropriate Bureau officials. Under the Bureau practice and the necessities of this particularly difficult case, there will probably be an interval of at least two months before an agreement can be reached with those who must approve it, if it is accepted. It can be revoked at any time prior to such acceptance and there will be ample time for consideration by you and your associates before definitive action is taken.

If the Government approves the proposed basis for settlement, it will be an unusually advantageous disposition of the matter. The doubts as to the construction of the applicable Internal Revenue Code provisions are so real and the factual background so involved, that the Government would certainly be fully justified in resisting our claim in its entirety, if complete recovery were to be sought for 1942 as well as avoidance of all liability for 1943 and the period ended April 30, 1944. We would then be compelled to pursue our rights even to the Supreme Court of the United States. In any such extended litigation, we would necessarily incur all of the risks usually attendant upon any litigation, plus the inevitable bringing to bear on the problem, in behalf

Plaintiff's Exhibit No. 68—(Continued)
of the Government, of a succession of fresh and ingenious minds, eager to establish full tax liability in a case involving such large sums. The determination of the year of worthlessness is a factual matter involving a risk of loss which in itself, in my carefully considered opinion, fully justifies the proposed basis of settlement. This is entirely apart from other serious defenses which would most certainly be asserted by the Government, if it were to contest our position in the case.

It is, therefore, my definite recommendation that in the event the Government advises us of its willingness to close the matter on the basis suggested in the attached proposal, that the matter be so disposed of as promptly as possible. You will, of course, be advised promptly of any definitive corporate action required from your corporation to that end. I cannot impress upon you too much the depth of my conviction as to the importance of moving promptly when and if opportunity arises to close this matter on the basis proposed. I am fortified in this by the years of my experience in the Bureau of Internal Revenue and my knowledge of the extreme sensitivity which attends the situation in the Bureau in any case of this magnitude.

I will be glad to discuss this matter with you and your associates at any convenient time.

Very truly yours,

/s/ JAMES K. POLK.

Plaintiff's Exhibit No. 68—(Continued)
(Copy)

Whitman, Ransom, Coulson & Goetz
40 Wall Street, New York 5, N. Y.

February 11, 1947.

The Honorable Joseph D. Nunan, Jr.,
Commissioner of Internal Revenue,
Washington, D. C.

Attention: Mr. Frank Eddingfield.

Re: The Western Pacific Railroad Corporation and Affiliated Corporations
1942, 1943 and 1944 Federal Income Taxes.

Dear Sir:

The Western Pacific Railroad Corporation and its affiliated subsidiaries filed consolidated returns for the calendar years 1942 and 1943 and the said Western Pacific Railroad Corporation filed a consolidated return for the calendar year 1944 including therein its said subsidiaries for the period from January 1, 1944, to April 30, 1944, during which period affiliation existed.

On the said return for 1942 a consolidated tax liability of \$4,201,821.54 was reported and duly assessed and paid. On the said return for 1943 there was reported a net loss and no taxable income. On the said return for 1944, based on a carryover of the unused 1943 net loss, there was reported no taxable income and no tax liability. A claim for refund of the tax so paid for 1942, based on a carryback of the said

Plaintiff's Exhibit No. 68—(Continued)

1943 net loss, was filed and is now pending in your office.

The taxpayer on behalf of itself and its aforesaid affiliated subsidiaries hereby offers to settle and determine the tax liabilities of the said corporations for the said taxable years 1942, 1943 and 1944 in the amounts shown on the returns filed as aforesaid. This proposal of settlement does not relate to or affect the tax liability of the said subsidiaries from and after April 30, 1944, when their affiliated status with The Western Pacific Railroad Corporation was terminated. The within proposal is made without prejudice to any rights or claims of the parties, if the proposal is not accepted by you.

As part of this proposal The Western Pacific Railroad Corporation, on behalf of itself and its aforesaid affiliated subsidiaries agrees that, if this proposal is accepted, it will consent to a rejection of the said claim for refund of the 1942 taxes and further agrees not to sue upon said claim or file other or further claims in respect of 1942 taxes on any ground whatsoever. It is further agreed by the said The Western Pacific Railroad Corporation on behalf of itself and its aforesaid affiliated subsidiaries that if this proposal is accepted it will execute or procure the execution of any other or further agreements or assurances requested by the Commissioner of Internal Revenue for the purpose of effectuating the settlement.

Authority for the submission of the within propo-

Plaintiff's Exhibit No. 68—(Continued)
sal of settlement by the undersigned is contained in
a Power of Attorney heretofore filed in your office.

Respectfully,

THE WESTERN PACIFIC
RAILROAD CORPORATION

JAMES K. POLK,
Attorney-in-Fact.

[Endorsed]: Filed Feb. 3, 1949.

PLAINTIFF'S EXHIBIT No. 69

The Western Pacific Railroad Corporation
100 West Tenth Street,
Wilmington 99, Delaware.

May 5, 1947.

At: New York 5, N. Y.
40 Wall Street,
Fifty-first Floor.

Mr. James K. Polk,
Messrs. Whitman, Ransom, Coulson & Goetz,
40 Wall Street,
New York 5, N. Y.

Dear Mr. Polk:

After the conference between the Board Committee dealing with Corporation tax matters, and yourself, held in your office on April 15th, we have further

considered the questions involved and the points raised at the conference.

We are prepared to recommend to the Board the sending to you of a letter of general approval of the proposed tax settlement, outlined in your letter to the Corporation under date of April 2nd, signed by myself as President, with a copy of an authorizing resolution of the Board.

We will expect to be informed as to the progress of the negotiations and if there are any changes in the proposed settlement the Corporation must be entirely free to reconsider its approval.

Although we wish to be entirely cooperative in this matter, the Corporation finds itself embarrassed by the action of the Western Pacific Railroad Company in opposing judicial settlement of the allocations of tax benefits, if any, derived from the application of the capital losses of the Corporation for the benefit of the Group. The Railroad Company's pleadings that the Railroad Corporation should be denied its day in court by reason of the statute of limitations and the District Court's injunctive order in reorganization, does not invite the kind of cooperation from the Railroad Corporation that a settlement of the tax case, so ably and fairly proposed by you as counsel for both the Railroad Company and the Railroad Corporation, requires. Had there been any question of the Railroad Corporation's right to a determination of the question of allocations of tax benefits, we feel sure that counsel representing both the Railroad Company and the Railroad Corporation would have

specifically stipulated, at the time of the filing of the consolidated returns, for such allocation to be determined by the court, if the parties found themselves unable to agree thereto. Inasmuch as in the proposed settlement the Railroad Corporation foregoes its refund claim of \$4,200,000, we think it appropriate that a stipulation promptly be entered into between the Railroad Company and the Railroad Corporation, and the other members of the Group, which will insure the Corporation its day in court for a settlement of the questions of proper and equitable allocations of tax savings, if any, as well as fixing the amount of the refund as the basis for such savings.

We trust you will use your good offices, representing both parties in this situation, to secure the approval of the Railroad Company to such a stipulation.

Very truly yours.

/s/ M. J. CURRY,
President.

cc: Mr. F. C. Nicodemus, Jr.

Mr. A. Perry Osborn

Mr. Willis D. Wood

[Endorsed]: Filed Feb. 3, 1949.